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Supreme Court of the United States

OCTOBER TERM, 1940

No. 872

313 U.S. #14
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A. B. GOCHENOUR, et al.,

Petitioners,

vs.

GEORGE AND FRANCES BALL FOUNDATION, GEORGE A. BALL and F. B. BERNARD,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT THEREOF

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INDEX.

SUBJECT INDEX.

Page

Petition for writ of certiorari 1

Statement of the matter involved 2

Questions presented 6

Reasons for the allowance of the writ 7

Prayer for relief 7

Brief in support of petition 8

Jurisdiction to grant the writ 8

Opinions below 8

Statement of the case 9

Argument 12

Summary of the argument 12

I. The cause of action is not derivative from the Debtor and was properly brought by the petitioners as a distinct class of creditors. The decision that such a cause passed to the Debtor in its capacity as trustee under 77B is in conflict with other decisions, and with fundamental law..... 12

(a) The decision in the instant case that an action for fraud available to a fraction of the creditors passes to a Debtor in possession in its capacity as Trustee in Bankruptcy is in conflict with decisions from other Circuits 13

(b) The cause of action was predicated on fraud by third parties to a distinct class of creditors, not common with stockholders or other creditors, and such a cause is not derivative, and the distinct class of creditors defrauded had the right to maintain the action in their name..... 14

(1) Only such creditors who were defrauded by the common scheme and who had no notice of the facts may maintain the action, to the exclusion of those who participated therein, knew the facts, and permitted the acts to be performed 16

(2) The theory that after insolvency the directors are trustees for the creditors only, excludes the corporation as a plaintiff, and it may only be a nominal party, but the action is only available to the creditors..... 17

(3) The gravamen of the complaint was based on a conflict of interests between the plaintiffs as existing bona fide creditors and other creditors who stood in a different class. There being no community of interest among the classes, the corporation was not the representative of the plaintiffs, and the action was properly commenced in their name..... 19

Page

II. The exclusive jurisdiction under 77B was confined to the res administered there, and not to the action in personam against the Indiana residents, and if such jurisdiction existed it was surrendered to the petitioners as creditors.... 19

(a) The Debtor having refused to prosecute the cause of action, the right accrued to the plaintiffs as creditors 20

(b) The Order entered in the 77B proceedings that the Debtor was neither a proper, necessary nor indispensable party to the cause of action as stated in the complaint, constituted an adjudication that such cause of action did not belong to the Debtor and a relinquishment of any claim to jurisdiction.... 21

(c) The adjudication in the 77B proceeding that the Debtor was not a proper party to the action commenced by the plaintiffs can only be reconciled with a determination and adjudication that the cause of action belonged to the creditors..... 22

(1) The question whether the Debtor was a proper party depended upon the asserted cause of action in the complaint and upon no other cause or showing, and the determination that it was not a proper party constituted an adjudication 23

(2) If the action as asserted in the complaint was derivative from the Debtor, the Bankruptcy Court could not have concluded that the Debtor was not even a proper party as such a Debtor is an indispensable party..... 23

(3) Even if the action is derivative it was proper to join the Debtor in an action by creditors, and the determination that the Debtor was not even a proper party constituted an adjudication that the action was not derivative 26

(d) Even if the cause of action belonged to the Debtor the jurisdiction was relinquished in favor of the plaintiffs as creditors, and the cause of action was properly brought by them, and the order of dismissal should be reversed 26

(1) The Bankruptcy Court under 77B was authorized to relinquish its exclusive jurisdiction and permit the creditors to sue in their own name if such exclusive jurisdiction existed 28

(2) The jurisdiction was relinquished by the order that the Debtor need not be made a party 28

III. The suit against the nonresidents in Ohio was under no possible theory an interference with the administration of the bankruptcy estate in the 77B proceedings, and if the dismissal of the cause will be sustained such cause will be forever lost to the plaintiffs as well as to the entire estate 29

Page

(a) Section 77B was not enacted for the purpose of permitting a corporation to initiate proceedings for alleged reorganization purposes as a means to deprive creditors of their rights and remedies indefinitely 30

(b) The Statute of Limitations having intervened, no other cause of action may be maintained, and the cause of action will be forever lost to the entire estate 31

(c) The defense of laches may be available against the Debtor, and the rights of the Creditors should not be prejudiced by making such defenses available.... 31

IV. The fraud of Midamerica Corporation was adjudicated. The recovery from the defendants is clear. The rights of the creditors should not be sacrificed on the legal fiction that the debtor instead of the creditor is entitled to maintain the action 32

TABLE OF CASES.

Babbit v. *Read*, 236 Fed. 42.....7, 14
Baily v. *Ramsey*, 285 Pa. 521..... 15
Baltimore, C. & A. Ry. Co. v. *Godffroy*, 182 F. 525..... 19
Bothe, Re, 173 F. 597..... 14
Boyd v. *Schneider*, 131 F. 223..... 14
Carey v. *Brown*, 92 U. S. 171..... 25
Chappel v. *First Trust Co.*, 30 Fed. Supp. 763..... 33
Charlesworth v. *Hebsch, Inc.*, 84 F. (2) 834..... 31
Chesbrager v. *Woodwerts*, 195 F. 875, 880..... 17
Clark v. *Miller*, 142 Pac. 918 (Cal.)..... 30
Conway v. *Bonner*, 100 F. (2) 786.....7, 17
Dewing v. *Perdicaries*, 96 U. S. 193..... 16
Diversey Building Corporation, 86 F. (2) 456.....7, 14
Dunning v. *Bates*, 186 Mass. 123..... 18
Gochenour v. *J. P. Morgan & Co.*, 111 F. (2) 378..... 10
Gochenour v. *Cleveland Terminals Bldg. Corp.*, Case No. 8708, C. C. A. 6 8
Green v. *Brophy*, 110 F. (2) 539..... 19
Hackner v. *Guaranty Trust Company of New York*, 117 F. (2) 95....14, 17
Hanna v. *Brictson Manufacturing Co.*, 62 F. (2) 139..... 26
Harvard v. *United States Shipping Board*, 32 F. (2) 68..... 7
Hirschfeld v. *McKinley*, 78 F. (2) 124.....7, 13
Hubbard v. *United Utilities Telephone Co.*, 115 N. Y. 1016..... 18
Irving Trust Co. v. *Deutch*, 73 F. (2) 127..... 33
Meikle v. *Drain*, 69 F. (2) 290..... 31
Monarch Anthracite Mining Co. v. *Coffin*, 102 F. (2) 337..... 20
Railway Express Agency v. *Jones*, 106 F. (2) 341..... 17
Ripperger v. *Allyn*, 25 Fed. Supp. 554..... 33

Page

Rosenblum v. *Dingfelde*, 2 Cir., 111 F. (2) 407 29
1775 Broadway Corporation, 82 F. (2) 186 ..... 7, 14
Savage Wholesale Grocery Co. v. *Republic Ins. Co.* (Texas), 70 S. W. (2) 663 21
State of Washington v. *United States*, 9 Cir., 87 Fed. (2) 421 25
Thomas v. *Mathews*, 94 O. S. 32 18
Thompson v. *Terminal Shares*, 104 F. (2) 1, 8 20
United States v. *Tacoma Oriental S. S. Co.*, 86 F. (2) 363 20
Utilities Power and Light Corporation, 91 F. (2) 598 30
Walpert v. *Cripton*, 2 Pac. (2) 267 32
Winn v. *Harby*, 172 S. E. 135 (S. C.) 16
Young Love v. *Lime Co.*, 49 O. S. p. 663 18

OTHER AUTHORITIES.

34 C. J., p. 502 25
42 C. P., p. 494, Par. 492 25
Fletcher, Cyclopedia Corporations, Vol. 3, Sec. 1313 (1931 Edition) 15
Gerdes on Corporate Reorganization, Vol. I, Sec. 405 (1937 Supp.) 13
Remington on Bankruptcy, Sec. 2331 15
Remington on Bankruptcy, 1939 Supp., Sec. 2344, p. 55 32
Remington on Bankruptcy, Sec. 2335.25 32

STATUTES CITED.

Sec. 77B(c)(14) 28

OTHER REFERENCES.

Report No. 25, Part 25, Senate Committee under S. Res. 71 of December 19, 1940, entitled Alleghany System—Midamerica Corporation: Its Uses as a Holding Company 11
Report No. 25, Part 26, Senate Committee under S. Res. 71 of December 19, 1940, entitled Alleghany System—Sale by George A. Ball: Tax Avoidance Through Charitable Foundations 11
Report No. 25, Part 27, Senate Committee under S. Res. 71 of December 19, 1940, entitled Alleghany System—Acquisition of Control by Robert R. Young 11

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GEORGE AND FRANCES BALL FOUNDATION, GEORGE A. BALL and F. B. BERNARD,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITION FOR WRIT OF CERTIORARI

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioners, A. B. GOCHENOUR, ANNA L. LANG, JAMES B. DICK, AUGUST FEINE & SONS COMPANY, ISAAC BARNETT, MULJO HOLDING CO., EVELYN R. LOOK, CHARLES E. KINGSLEY, LOUIS NAPOLEON BUTLER, J. D. DWEES and R. H. JOSSLYN, petition this Court for the issuance of a Writ of Certiorari to review the order of the United States Circuit Court of Appeals for the Seventh Circuit entered January 21, 1941, affirming the order of the

District Court for the Southern District of Indiana, dismissing Petitioners' Complaint for want of jurisdiction.

Statement of the Matter Involved.

Petitioners are a distinct class of creditors who commenced suit in the District Court for the Southern District of Indiana on October 11, 1939, against the respondents, George and Frances Ball Foundation, George A. Ball and F. B. Bernard (R. 1-8). The suit was dismissed for want of jurisdiction on February 15, 1940, on the ground that the cause of action belonged to their debtor, The Cleveland Terminals Building Company, an Ohio Corporation, which is undergoing reorganization under 77B at Cleveland, Ohio, since October 13, 1936. Its voluntary petition was approved on October 15, 1936 and it was allowed to remain as debtor in possession without the appointment of a Trustee.

Respondents are officers, directors and stockholders of Midamerica Corporation which they organized (together with the principal officers of The Terminals Company) on September 26, 1935, for the purpose of purchasing, at a friendly sale, the pledged assets of The Terminals Company for their personal benefit, in fraud of the then existing creditors. They purchased at the price of $318,000.00 (R. 4) assets which yielded them, two years later, over $6,000,000.00 (R. 6). They also purchased at that sale for $887.00 a claim for $13,787,-000.00 against The Terminals Company, and purchased for $2.00 another claim of $1,348,614.99 (R. 32). After they acquired all of these assets and claims they plunged The Terminals Company into bankruptcy under Section 77B, obtained an order against the plaintiffs restraining them from taking any action, and filed these claims seeking to recover the full amount. The Terminals Company, the "Debtor," consented to the allowance of the claims in full (R. 37). Petitioners filed their objections

to the claims and insisted on the appointment of a Trustee. Instead of appointing a Trustee, the Court appointed "special counsel" who later adopted Petitioners' Objections. These claims were allowed for the purchase price of $889.00, and not for the amount of the claims in the sum of $15,135,614.99. In disallowing the claims as requested, the Court found (R. 37):

> (a) That Midamerica Corporation, on September 30, 1935, on the occasion of its purchase of the bonds, the subject matter of the proof of claim filed by it, and thereafter, was a combination in corporate form participated in by the directors of The Cleveland Terminals Building Company, formed and utilized for the purpose, among other things, of divesting The Cleveland Terminals Building Company of its property, and of obtaining claims against said The Cleveland Terminals Building Company at a sacrifice, or at the lowest price possible, for the profit of said combination, at the expense and to the detriment of The Cleveland Terminals Building Company.
>
> (b) that Midamerica Corporation purchased the bonds, the subject matter of its proof of claim, at the auction sale held September 30, 1935, at the sum of $2.00 for the claim of $1,348,614.99, and $887.00 for the claim of $13,787,000.00.
>
> (c) that The Cleveland Terminals Building Company was insolvent in September 30, 1935, and that it could not meet its obligations as they fell due.*

No action was taken by the Debtor (which stood in the capacity of Trustee for the creditors) to sue the Respondents or any of the parties for the illegal profits which they made out of the purchase of the assets, although the facts were known to it as revealed by the objections to the claim of Midamerica and its assignees, the Respondents herein. The period of limitation for

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* Midamerica prosecuted an appeal from this order which is now pending in the Sixth Circuit.

such a cause under the Ohio Law expired September 30, 1939 (R. 41).

Petitioners filed their main suit in the Federal Court at Cleveland on September 11, 1939 (a few days before the expiration of the period of limitation) against Midamerica and its officers who resided in that District (R. 18). They asked for leave to join the Debtor as a party but the Bankruptcy Court denied such leave on the ground that it was not alleged in the Complaint that it was a necessary party (R. 29).

The Complaint (R. 1-8) was founded on the doctrine that the principal officers of the Debtor were trustees for the plaintiffs as creditors, because of the insolvency of the Debtor at the date of the sale. They, the officers, owed a fiduciary duty to the creditors to inform them that the corporation was insolvent and was unable to bid at the scheduled sale, and to give the creditors the opportunity to protect their rights. It was based on the theory that the officers were accountable directly to the creditors as *cestui que trustants,* and that the Respondents who received their profits out of a combination with such unfaithful trustees were equally liable with them directly to the plaintiffs. While the original suit was filed as a class suit for the benefit of all creditors it was amended (R. 11) so as to seek relief for the distinct class of creditors who had no knowledge of the insolvency and of the scheduled sale, to the exclusion of creditors who were not defrauded, including therein J. P. Morgan & Co., a creditor in excess of $27,000,000.00, and the Van Sweringen Corporation, the parent of the Debtor, a creditor for a like amount, who were not defrauded (R. 11, 12). The Amendment stated that the suit was filed only "for the benefit of the plaintiffs and the other creditors who had no knowledge of the facts pertaining to the acquisition of the collateral."

Respondents moved to dismiss the cause of action (R. 9) on the ground that the right of action belonged to the Debtor and that the Bankruptcy Court at Cleveland which administered its property under Section 77B had exclusive jurisdiction. On February 15, 1940, the District Court rendered a decision (R. 42-60) sustaining the position of the Respondents, and it entered an order on February 24, 1935, as of February 15, 1935, dismissing the cause of action for want of jurisdiction. An appeal was taken to the Seventh Circuit, and the Statement of Points presented to that Court urged the following (R. 61):

> 1. The cause of action is predicated upon a wrong done to the plaintiffs who stand in a particular class of creditors and which is not common to all creditors. The plaintiffs are therefore the proper parties to assert a cause on behalf of themselves and the particular creditors who are similarly situated.
>
> 2. The cause of action is not an asset of the bankruptcy estate, and this suit did not interfere with the administration of the Debtor's estate under the 77B proceedings.
>
> 3. The District Court in charge of the 77B proceeding had adjudicated that the Debtor was neither a proper, necessary or indispensable party, and its adjudication was binding upon the court.
>
> 4. The Statute of Limitations having intervened, and there being no possible chance for the Debtor's estate to maintain any cause of action, it was a gross error to dismiss the proceedings, thus defeating a substantial recovery to the plaintiffs and those who are similarly situated.
>
> 5. The capacity of the plaintiffs to maintain the action must be raised by an answer and not by a motion to dismiss, and the Court erred in sustaining the motions to dismiss.

The Seventh Circuit rendered an opinion on January 21, 1941 (R. 70) without discussing any of these points

but simply adopted the decision of the District Court which was published in 35 F. Supp. 508 as its decision, and entered an order affirming the judgment of the District Court (R. 71).

Questions Presented.

The points which were presented to the Seventh Circuit and which it failed to discuss, are the same points on which Petitioners rely in seeking a review here, and such points present the following questions:

1. Whether an action for fraud which is available to a distinct class of defrauded parties, not common with other creditors or stockholders, passes to a Debtor in possession in its capacity as Trustee in Bankruptcy so as to deprive the defrauded parties of their right to maintain an action in their name against the persons who defrauded them.

2. Whether a claim for fraud committed by third parties to a distinct group of creditors is an asset of a Debtor undergoing reorganization under Section 77B, particularly when such Debtor took no action to bring this asset under the administration of the Court and the statutory period of limitation had expired.

3. Whether the denial by a Bankruptcy Court of the request to join the Debtor as a party to proceedings commenced by creditors against third parties for fraud, constituted an adjudication that the cause of action did not belong to the Debtor, or a relinquishment of such exclusive jurisdiction in favor of such creditors.

4. Whether a Bankruptcy Court may on the one hand be said to have exclusive jurisdiction of a cause of action and permit a Debtor in possession, which stands in the position of Trustee, to remain passive without taking any action to bring such assets to the Bankruptcy Court until the intervention of the statutory period of

limitation and at the same time prevent creditors from pursuing their remedies to recover such assets for their own benefit.

Reasons for the Allowance of the Writ.

1. The decision of the Seventh Circuit that a cause of action for fraud, available to a distinct class of creditors against third persons, passes to a Debtor in possession in its capacity as Trustee under Section 77B, is in conflict with the decision of the Ninth Circuit in *Hirschfeld* v. *McKinley,* 78 F. (2) 124 and with the decisions of the Second Circuit in *Babbit* v. *Read,* 236 Fed. 42 (certiorari denied 243 U. S. 648); *Harwood* v. *U. S. Shipping Board,* 32 F. (2) 68, and *Re 1775 Broadway Corporation,* 82 F. (1) 186. It cannot be reconciled with the decision of the Fifth Circuit in *Conway* v. *Bonner,* 100 F. (2) 786, certiorari denied 307 U. S. 632. It is also inconsistent with its own decision in *Re Diversey Building Corporation,* 86 F. (2) 456.

2. It is not the purpose of the Bankruptcy Law to furnish immunity to wrongdoing by corporate officers. A Bankruptcy Court may not apply the doctrine that the rights of creditors pass to a Debtor in possession and permit it to sacrifice the cause of action and at the same time prevent the creditors from suing in their own right within the statutory period.

3. The Writ of Certiorari should issue in order to bring harmony in the conflicting decisions of the various Circuits on important Federal questions in the administration of the Law of Bankruptcy under Section 77B as well as under Chapter X of the present Act.

Prayer for Relief.

Petitioners therefore pray that a Writ of Certiorari be issued to review the judgment of the United States Circuit Court of Appeals for the Seventh Circuit made

and entered January 21, 1941 to the end that its judgment be reversed with directions to reverse the order of the District Court which dismissed petitioners' action for want of jurisdiction and that the respondents be required to answer on the merits.

Respectfully submitted,

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JOSEPH L. STERN,
HARRY J. MYERSON,
Counsel for Petitioners.

BRIEF IN SUPPORT OF PETITION.

Jurisdiction to Grant the Writ.

The jurisdiction to review the order of the Seventh Circuit is invoked under Section 240(a) of the Judicial Code as Amended by the Act of February 13, 1925 (43 Stat. 1938, 28 U. S. C. A. Sec. 47). The order of the Seventh Circuit affirming the order of the District Court was entered on January 21, 1941, and the petition is filed within the statutory period.

Opinions Below.

The Seventh Circuit rendered an opinion on January 21, 1941 (R. 70) which consists of one paragraph and which was published in 117 F. (2) 259. This opinion adopted by reference the opinion of the District Court which was published in 35 F. Supp. 508 (R. 42-60).

The question involved in this petition was incidentally presented to the Sixth Circuit in an appeal taken by these Petitioners in connection with the suit commenced by them in the District Court of Ohio. (*Gochenour et al.* v. *Cleveland Term. Bldg. Co.*, Case No. 8708, decided

March 3, 1941.) The Sixth Circuit reversed the order of the District Court in part and remanded the case with directions. On the issue, however, as to whether or not the cause of action belonged to the Debtor, it held that the right of action exclusively belonged to the Debtor and that Petitioners had no right to maintain the action. The opinion was rendered March 3, 1941, and is not yet final as the time for rehearing will not expire until April 3, 1941, and if it is made final we intend to present that opinion to this court on an application for a Writ of Certiorari.

Statement of the Case.

This is an action brought by a distinct class of creditors of The Cleveland Terminals Building Company, an Ohio corporation. Plaintiff, A. B. Gochenour and the other ten plaintiffs are residents of states other than Indiana. The defendant, George and Frances Ball Foundation, a corporation, and the individual defendants, are residents of Indiana. Plaintiffs sought to recover from the defendants over $6,000,000.00, which the defendants obtained as stockholders of Midamerica Corporation, the principal defendant in their main suit pending in the District Court of Ohio. This suit was ancillary to the Ohio suit, due to the nonresidence of the defendants there.

In the month of August, 1935, O. P. and M. J. Van Sweringen (now deceased), together with one, Charles L. Bradley (principal officers and directors of the Debtor) entered into a conspiracy with the Indiana defendants, George A. Ball and F. B. Bernard and others, for the purpose of defrauding the plaintiffs, the then existing creditors of the Debtor (R. 3). On October 31, 1930, the Debtor had executed its note for $23,500,000.00, secured by collateral consisting of Alleghany Common Stock and other securities. This note, together with the

collateral, was delivered by the Debtor to its Parent, the Vaness Company, which owned all of the stock of the Debtor. At the same time "Vaness" executed its note for $16,000,000.00, secured by other collateral. O. P. and M. J. Van Sweringen and Charles L. Bradley (who controlled the "parent" and "child") delivered both notes, as well as all of the collateral, to J. P. Morgan & Co. as security for a loan.* The collateral remained with "Morgan" until September 30, 1935, when it was sold at an alleged auction to a corporation, organized on the eve of the sale, under the name of Midamerica Corporation by the Van Sweringen interests, the Ohio residents, and the Ball interests, the defendant herein (R. 3-4).

The Debtor was insolvent at the date of the sale (R. 3). Its principal officers stood then in the relation of trustees for the plaintiffs, the existing creditors. It became their duty as such trustees to exert every effort to protect the collateral for the benefit of such creditors. Knowing of the scheduled sale and concealing it from the creditors, they entered into a conspiracy with the defendants to create the Midamerica Corporation and to purchase in its name the collateral for their personal gain and profit. The Midamerica Corporation was organized pursuant to said conspiracy on September 25, 1935. They elected O. P. Van Sweringen as Director and President and M. J. Van Sweringen and Charles L. Bradley as Directors and Vice-Presidents. The defendants, G. A. Ball and F. B. Bernard were also elected as Directors. Said O. P. Van Sweringen was authorized to purchase on behalf of Midamerica the collateral, and he purchased in its name the collateral pledged under the $23,500,000.00 note at the price of $318,000.00. This collateral had then an actual market value in the sum

* The legality of the loan was the subject matter of an appeal taken by the same petitioners and it was determined that as to $5,000,000 of the loan there was fraud (Gochenour v. J. P. Morgan & Co., 111 F. (2) 378.

of $2,134,068.15. They realized an immediate profit on the basis of the then market value of $1,816,068.75 which increased in value thereafter to over $6,000,000.00. They realized from the sale of the collateral $6,805,800.00. Thereafter, the defendants, George A. Ball and F. B. Bernard, acquired all of the stock of Midamerica Corporation, and said Midamerica Corporation distributed the proceeds realized from the sale of the collateral to the defendants, including George and Frances Ball Foundation, a corporation, created by said Ball and Bernard (R. 4-6).*

Midamerica also purchased at that sale one claim against the Debtor in the amount of $13,787,000.00 at the price of $887.00, and another claim of $1,348,614.99 at the price of $2.00. After acquiring the aforesaid assets and realizing the profit thereon, it filed these claims against the Debtor in the 77B proceedings, and the Respondent, George and Frances Ball Foundation, appeared in that proceeding seeking to sustain the claim (R. 36-37). The court denied the claims as requested in the sum of $15,135,614.99 and only allowed the claimant to recover the purchase price in the sum of $889.00 (R. 37). In denying such claims the Court found that Midamerica on the occasion of its purchase "was a combination in corporate form participated in by the directors of The Cleveland Terminals Building Company" for the purpose of divesting it of its property and of "obtaining claims against said The Cleveland Terminals Building Company" at the expense of the Debtor (R. 61). However, no action was taken to recover the $6,000,000.00 in profits realized by it and the Respondents as a

* For the history of the "Morgan" sale, the creation of "Midamerica" and "Ball Foundation" see the following Reports of the Senate Committee under Resolution 71 of December 19, 1940:

Report No. 25, Part 25, entitled: Alleghany System—Midamerica Corporation: Its Uses as a Holding Company.

Report No. 25, Part 26, entitled: Alleghany System—Sale by George A. Ball: Tax Avoidance Through Charitable Foundations.

Report No. 25, Part 27, entitled: Alleghany System—Acquisition of Control by Robert R. Young.

result of their conspiracy and the statutory period of limitation of Ohio expired September 30, 1939.

Petitioners filed their suit in Ohio on September 11, 1939, within the statutory period (R. 18), and they commenced this suit in October, 1939 (R. 1-8). They alleged in their complaint in this cause that the Petitioners, prior to the institution of this suit, commenced a similar action against Midamerica Corporation, but due to the fact that the defendants to this cause were non-residents in Ohio it was necessary to commence this action in Indiana. It stated that Debtor was a proper party plaintiff or defendant, but due to the fact that it was administered by the District Court at Ohio under Section 77B it was necessary to obtain leave of that court to join it as a party; that an application was made to that court to join it as a party; that the court determined that the Debtor was neither a proper, necessary nor indispensable party (R. 7).

The motion of the Respondents (R. 12) to dismiss this cause because the right of action was not vested in them but in the Debtor was sustained by the Court on February 15, 1941 (R. 36), and was affirmed by the Seventh Circuit on January 21, 1941 (R. 71).

ARGUMENT.

I.

The cause of action is not derivative from the Debtor and was properly brought by the petitioners as a distinct class of creditors. The decision that such a cause passed to the Debtor in its capacity as trustee under 77B is in conflict with other decisions, and with fundamental law.

In deciding that the cause of action was derivative, and belonged to the Debtor, the opinion of the trial

Court which was adopted by the Seventh Circuit, states (R. 60):

> "It is clear that a 'cause of action' is an asset or a property right of the individual to whom it belongs. It is equally clear that, under the Bankruptcy Act, the title to a 'cause of action' which belonged to the individual prior to bankruptcy passed to the trustee in bankruptcy upon adjudication."

The Court overlooked the fact that this was *not an action which belonged to the bankrupt* prior to its bankruptcy, but belonged to the plaintiffs as a *distinct class* of creditors, not common with other creditors or with stockholders, and that *such an action is not derivative* and is not an asset of the bankrupt.

(a) The decision in the instant case that an action for fraud available to a fraction of the creditors passes to a Debtor in possession in its capacity as Trustee in Bankruptcy is in conflict with decisions from other Circuits.

The decision holds that an action for fraud to a distinct class of creditors passes to a Trustee in Bankruptcy or to a Debtor in possession which stands in such capacity. This is *in direct conflict* with the decision of the Ninth Circuit in *Hirschfeld* v. *McKinley,* 78 F. (2) 124, where the Court reached the *opposite* conclusion. It said:

> "The Trustee in Bankruptcy, of course, represents all the creditors and cannot bring a fraud action on behalf of only a fraction of them."

and concluded that no such action passes to a Trustee in Bankruptcy. Certoriari was denied here (297 U. S. 703).*

The Second Circuit adopted the same view in *Harwood* v. *United States Shipping Board,* 32 F. (2) 680. There,

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* This case is relied on as authority for the proposition that a trustee under 77B is not vested with the right of action for fraud to creditors in Gerdes on Corporate Reorganization (1937 Supp., Sec. 405).

it held that a cause of action for fraud to a distinct class of creditors does not pass to the Trustee in Bankruptcy and can only be maintained by such creditors. It applied this doctrine to Section 77B in *Re 1775 Broadway Corporation,* 82 F. (2) 186. Its recent decision in *Hackner* v. *Guaranty Trust Company of New York,* 117 F. (2) 95, pending here on Certiorari in Case Number 799, seems to hold the same view.* In fact, the Seventh Circuit arrived at a similar conclusion in *Re Diversey Building Corporation,* 86 F. (2) 456, and its decision there that a cause of action by creditors against third parties is available to such creditors only and is not within the jurisdiction of the Bankruptcy Court cannot be harmonized with the decision in the instant case.

The opinion of the Sixth Circuit in the appeal from the other suit by these petitioners which is not yet final cited a decision from the Eighth Circuit holding that claims for fraud available to a fraction of the creditors pass to the Trustee in Bankruptcy (*In Re Bothe,* 173 F. 597).** We recognize that there is a direct conflict between the several circuits and the writ should be issued to settle an important federal question.

(b) The cause of action was predicated on fraud by third parties to a distinct class of creditors, not common with stockholders or other creditors, and such a cause is not derivative, and the distinct class of creditors defrauded had the right to maintain the action in their name.

This was a cause of action belonging purely to the class of creditors who were defrauded and not to the Debtor. This was squarely held in an earlier case by

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* The subject matter in that suit involved the notes in the amount of $13,787,000.00 which Midamerica acquired from "Morgan" at the price of $887.00.

** The contrary was held in *Babbit* v. *Read,* 236 Fed. 42, certiorari denied 243 U. S. 648.

the Seventh Circuit in *Boyd* v. *Schneider,* 131 F. 223. There, the cause of action was for the fraud of the directors in paying out dividends when in fact no such dividends were earned. In determining that this was *not a derivative action* but an action belonging *to the creditors who were defrauded,* this Court said:

> "It seems clear to us that on such state of facts, the directors are answerable in some kind of action, *directly to the persons to whom their duty ran.*"

This Court further said:

> "On the whole matter our conclusion is, that considering arguendo that the receiver might have brought the action stated in the bill, his right to bring such action is not exclusive; and that, to the extent the *directors are responsible specially to the depositors, the depositors have a right of action*— an action, adequate to the fulfillment of the obligation due the depositors by the directors." (Italics ours.)

This applies with equal force here.

A general statement of the rule applicable to this situation is to be found in Fletcher, Cyclopedia Corporations, Vol. 3, Sec. 1313 (1931 Edition), wherein the writer of the text states:

> "The corporation is not a necessary party * * * where the right to proceed against the officers never belonged to the corporation and was no part of its assets * * *
>
> "* * * the corporation need not be made a party where * * * the plaintiffs have no claim against the company. And where plaintiffs' cause of action is for deceit practiced on them by corporate officers, the latter only are liable in damages." *

In *Baily* v. *Ramsey,* 285 Pa. 521, the suit was by creditors against the directors of a corporation to declare the directors as trustees for moneys diverted by them. The Court said (p. 526):

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* See also the application of the rule to 77B in Gerdes on Corporate Reorganization, Section 405 (1937 Supp.).

> "Plaintiffs' cause of action is for a deceit practiced on them by defendants; hence the former alone are interested in the recovery, and only the latter are liable in damages. Under such circumstances, the corporation would not have been a proper party."

In *Dewing* v. *Perdicaries,* 96 U. S. 193, the distinction was well pointed out between a right of action which belongs to the corporation and where the corporation is an indispensable party, and the right of action which is available to an individual and where the corporation may be a proper party but not a necessary or indispensable party. The test in such case is *whether the entire cause of action wholly belongs to the corporation* or the cause of action belongs to *a particular class* as distinguished from the corporation. In that case a shareholder brought an action, and the question was whether the action could be maintained in his own name, and the Court there said (p. 196):

> "Where a cause of action affects the entire interests of a corporation as such, the corporation is the proper party to sue. Where it affects specially a stockholder, he has the same right to sue *pro interesse suo* as any one else. In the latter case, it may or may not be necessary to make the corporation a party. As between the complainant and the party who bought his stock at the pretended sale, the conflict was primarily between them. The question was one of *meum* and *tuum.*"

The distinction was also clearly set out in *Winn* v. *Harby,* 172 S. E. 135 (S. C.).

(1) Only such creditors who were defrauded by the common scheme and who had no notice of the facts may maintain the action, to the exclusion of those who participated therein, knew the facts, and permitted the acts to be performed.

Creditors who were defrauded by a common scheme or device may maintain a class suit against the persons

who defrauded them and the right of action is vested in such creditors and is *not in common with those who were not defrauded* (*Chesbrager* v. *Woodwerts,* 195 F. 875, 880, C. C. A. 6; *Railway Express Agency* v. *Jones,* 7th Cir., 106 F. (2) 341. The Second Circuit recently held that there can be no common action for fraud and that the right belongs to each creditor *separately* (*Hackner* v. *Morgan,* 117 F. (2) 95). In that case the Court even held that creditors lacking the jurisdictional amount may not join with a creditor who has the jurisdictional amount under Rule 23(c) on the ground that each fraud claim was separate and distinct. This suit involved an action for fraud pertaining to a $30,000,000.00 note issue of the Van Sweringen Corporation, $13,787,000.00 of which notes were sold to Midamerica at the "Morgan" sale involved here. If it be true that the fraud action is "derivative" the court could not have reached the conclusion that the suit did not involve a class action. It is true that we applied for a certiorari here in that case, but we did not contend that the action did not belong to the creditors.

(2) The theory that after insolvency the directors are trustees for the creditors only, excludes the corporation as a plaintiff, and it may only be a nominal party, but the action is only available to the creditors.

The Court had for its consideration the cause of action as asserted in the complaint. *It was not asserted that the Debtor was defrauded.* On the contrary, the Debtor, through its officers, *was a party to the fraud.* The cause as stated was, that the directors were trustees, *after insolvency, not for the Debtor but for the plaintiffs as creditors.** This was not a cause of action common be-

* See *Conway* v. *Bonner,* 5th Cir., 100 F. (2) 786 (certiorari denied 307 U. S. 632) where the court made such a distinction and concluded that the right of action was not in the Bankruptcy Trustee.

tween the stockholders and creditors, but was in favor of the particular class of creditors who were *in esse* at the date of the alleged fraud. It was not a cause of action which was available to all creditors but only to the creditors who had no notice of the fraud. If the transaction occurred while the corporation was solvent the right of action would have been in the corporation as the directors of the corporation during solvency stand as trustees for the stockholders. The rule is different, however, *after insolvency* when the directors become *trustees for the creditors only.* The rule was adopted in Ohio (*Young Love* v. *Lime Co.,* 49 O. S. p. 663; *Thomas* v. *Matthews,* 94 O. S. 32, 47), and the Ohio law is controlling on the validity of the claim. The term "derivative" does not apply to an action based on the trust theory (*Hubbard* v. *United Utilities Telephone Co.,* 115 N. Y. 1016).

In *Dunning* v. *Bates,* 186 Mass. page 123, the plaintiffs, as bondholders, sued the trustees for malfeasance and misfeasance without bringing the suit in the name of the corporation and without joining the corporation. A demurrer was filed to the complaint and one of the points upon which the trial court sustained it was that the action was derivative. In overruling this contention the court pointed out that this was a suit between beneficiaries against their trustees, and the corporation was merely an instrumentality but was not the party in whom the cause lodged. The Court said (p. 310):

> "Neglect or misfeasance of trustees is a breach of duty toward the *cestui que trust,* for which they are entitled to a remedy directly against the trustees, under the agreement to which they and the trustees were the only parties."

The Court said:

> "We have no doubt that the bondholders may proceed directly against the trustees to obtain a remedy for a failure to account in a case of this kind."

(3) The gravamen of the complaint was based on a conflict of interests between the plaintiffs as existing bona fide creditors and other creditors who stood in a different class. There being no community of interest among the classes, the corporation was not the representative of the plaintiffs, and the action was properly commenced in their name.

In *Baltimore, C. & A. Ry. Co.* v. *Godffroy,* 4 Cir., 182 F. 525, the Court held that a corporation is the representative of the stockholders "when the claim of the complainant relates to matters common to all classes," where they have "a community of interest," but where the suit "involves a conflict" between different classes, then "the representative character of the corporation ceases." The Court quoted from various decisions and pointed out that "the foundation" of the rule that the corporation is the representative of the class is based on *"a community of interest"* but where the *"gravamen of the complaint consists of vital conflict of interest"* between the different classes "the rule concerning the representative character of the corporation ceases." This case was cited with approval in *Green* v. *Brophy,* 110 F. (2) 539 (1940) on the point that a Trustee is not the representative of the beneficiaries where the interest is in conflict.

II.

The exclusive jurisdiction under 77B was confined to the res administered there, and not to the action in personam against the Indiana residents, and if such jurisdiction existed it was surrendered to the petitioners as creditors.

The entire theory that the Debtor stands in the position of a trustee in bankruptcy and that the cause of

action is therefore in it, is founded on the mistaken idea that the positions of a Debtor and a Trustee in Bankruptcy are identical. The Debtor stands in the position of a trustee in the sense that it must account as trustee for the administration of the property. Its acts as trustee are confined to the administration of the *res*. A corporation which committed fraud against the creditors cannot be transformed, by any device, to a plaintiff on the part of the defrauded party. In *United States* v. *Tacoma Oriental S. S. Co.,* 86 F. (2) 363, it was said:

> "We believe that the act giving exclusive jurisdiction of the lower court over the debtor's property wherever located simply means that the *res* (the debtor's property) is to be considered solely under the jurisdiction of the lower court. Any wrongful invasion, interference, or disposition of that *res* is to be dealt with solely by the lower court. Jurisdiction over a person outside the lower court's jurisdiction, is given to the lower court, only if such person is in some manner invading, interfering, or disposing of the debtor's *res,* and then only to the extent of preventing or forestalling the invasion, interference or disposition of such *res.*"

The case is cited with approval in *Thompson* v. *Terminal* v. *Terminal Shares,* 8 Cir., 104 F. (2) 1, 8.

Under no stretch of the imagination could it have been the intent of Congress to vest the right of action of the defrauded parties in the person or corporation which committed the fraud.

(a) The Debtor having refused to prosecute the cause of action, the right accrued to the plaintiffs as creditors.

The identical question was decided adversely to the decision in this cause by the third circuit in *Monarch Anthracite Mining Co.* v. *Coffin,* 102 F. (2) 337. There, creditors filed a suit against third parties. The "main

averment" was that the defendants "through their control" of the Debtor, which was involved in 77B proceedings, "so manipulated its affairs" that its property and assets "have been wrongfully diverted to the defendants." In disposing of the contention that the creditors had no right to maintain the action and that the action was in the Debtor, the Court said (p. 339):

> "The bill was filed as a class bill under Equity Rule 38, 28 U. S. C. A. following section 723. It is well settled that an injured party may bring a bill to redress the injury complained of, either in his own name or as a class bill under Rule 38, when the corporation, in which is the right of action, refused to act. Equity Rule 27, 28 U. S. C. A. following section 723, regulates this in cases of stockholders, but we have no rule regulating creditors' bills. Rule 23 of the New Rules of Procedure, 28 U. S. C. A. following section 723c, gives recognition of the right."

This is on all fours as the answer of the Debtor (R. 27) constituted a refusal to act. See also *Savage Wholesale Grocery Co.* v. *Republic Ins. Co.* (Texas), 70 S. W. (2) 663.

(b) The Order entered in the 77B proceedings that the Debtor was neither a proper, necessary nor indispensable party to the cause of action as stated in the complaint, constituted an adjudication that such cause of action did not belong to the Debtor and a relinquishment of any claim to jurisdiction.

The complaint, in the Ohio suit, alleged that the Debtor should be joined as a party plaintiff or defendant but that no such joinder can be made without leave of the Bankruptcy Court due to the fact that it was administered under Section 77B. This allegation was made pursuant to the Civil Practice Act (Rule 19(c)).

A petition (R. 15) was presented in the 77B proceeding asking leave to join the Terminals Company as a plaintiff or defendant, based on the complaint, which was attached to the petition (R. 18). The answer of the Debtor (R. 27) was to the effect that it had no objection to being joined as a defendant provided no relief is sought against it. *It believed, however, that there were no prospects for recovery* (R. 28). The creditors' committee filed a memorandum asserting that the cause of action was in the plaintiffs, as creditors, and that the Debtor was neither a proper, necessary nor indispensable party (R. 32). The Master rendered his report on these pleadings. He recommended the denial of the petition on the ground that the Debtor was neither a proper, necessary, or indispensable party (R. 25), and the Court sustained this report (R. 29).

The decision in the 77B proceedings that the Debtor was neither a proper, necessary nor indispensable party to the cause of action as stated in the complaint (which complaint was the basis for the prayer to join it as a party) *constituted an adjudication that the cause of action belonged to the plaintiffs as creditors* and not to the Debtor and was *a relinquishment of any claim to the cause of action* by the Court under Section 77B. The Court clearly wrongfully construed the effect of the order.

(c) The adjudication in the 77B proceeding that the Debtor was not a proper party to the action commenced by the plaintiffs can only be reconciled with a determination and adjudication that the cause of action belonged to the creditors.

The complaint in the instant case alleged that the District Court at Ohio adjudicated that the Debtor was neither a proper, necessary nor indispensable party and that the cause of action was in the plaintiff, and it re-

linquished any right to the cause of action in favor of the plaintiffs (R. 11). The motion to dismiss admitted this allegation. The opinion says (R. 56, 57):

> "This statement of the Master in his report, which was approved by the court, indicates clearly that the Master believed that the 'cause of action' if any, asserted by plaintiffs in their Complaint, was an asset or property of the debtor, and that the petition for leave to make the debtor a party to the civil action, which was before him for consideration, was, in effect, a request on the part of plaintiffs, for the 'bankruptcy court to surrender to another court (in this instance the District Court) its jurisdiction over the debtor or its property.' This request was denied by the bankruptcy court, as shown by its order denying plaintiffs' petition. It is, therefore, apparent that the bankruptcy court considered the 'cause of action' if any, asserted in plaintiffs' Complaint to be an asset of the Debtor and, by its order, it refused to surrender to the District Court its jurisdiction over Debtor or its property."

The error is apparent. The Court, in the 77B proceedings, was confronted with the question whether the Debtor was a proper, necessary or indispensable party *to the cause as asserted* in the complaint. *The question for its determination was whether under the cause of action as stated in that complaint* the Debtor was a proper, necessary or indispensable party.

(1) The question whether the Debtor was a proper party depended upon the asserted cause of action in the complaint and upon no other cause or showing, and the determination that it was not a proper party constituted an adjudication.

The question whether the Debtor was a necessary party depended *on the allegations of the complaint* and

not on any other allegations or showing (Volume 13, Fletcher, Cyclopedia Corporations, Section 5912). If the Master and the Court believed that the "cause of action" *as "asserted"* in the complaint was *"an asset or property"* of the Debtor, *they could not have concluded,* as they did, that the Debtor, was neither a proper, necessary nor indispensable party. If it appeared from the "asserted" cause of action that the property was "an asset of the Debtor," as stated in the opinion, the Bankruptcy Court *could not have arrived at the conclusion that the Debtor was neither a proper, necessary, nor indispensable party.*

(2) If the action as asserted in the complaint was derivative from the Debtor, the Bankruptcy Court could not have concluded that the Debtor was not even a proper party as such a Debtor is an indispensable party.

A Trustee vested with a legal title to the property which is an asset of the bankrupt estate is an indispensable party (Remington on Bankruptcy, Section 2331). *The only justification for the order holding that Debtor was not even a proper party can only be reconciled with the theory that the cause of action did not belong to it;* that it had no right, title or interest therein and that it was therefore an improper party. True, the Master stated (R. 26) that no showing was made that the Debtor was a necessary party. *The request for leave to join the Debtor as a party was based on the complaint. No other showing was necessary or proper.* The conclusion of the Master and the affirmance of his report by the Court that upon the cause of action as stated in that complaint The Terminals Company was not a proper, necessary or indispensable party *can only be reconciled with a determination that the cause of action "as asserted"* was vested in the creditors and not in the Debtor. No proof is necessary for a determination

as to the capacity of a party to sue when the matter is presented to the Court on the pleadings (42 Corpus Juris, p. 494, Par. 492). The Court was called upon to determine whether under the cause of action as alleged in the complaint the Debtor was a proper party. *It was confronted with the cause of action as there alleged and with no other cause of action. When that Court concluded, determined and adjudicated that under the cause of action as stated in that complaint the Debtor was not even a proper party, it thereby adjudicated that the cause of action did not belong to it but belonged to the creditors.* The order must be given such a construction which is consistent and in harmony with the laws (34 C. J., page 502).

The statement in the opinion that the Bankruptcy Court determined that the Debtor was not a proper, necessary or indispensable party because no such allegation was made by the complaint is, of course, *contradicted by the complaint* which alleged that the Debtor "should be joined either as plaintiff or defendant" (R. 19). *An allegation that a party should be joined cannot be read as an allegation that the party is not a proper, necessary or indispensable party.* Whether the Debtor was a proper, necessary or indispensable party was presented to the court *on the face of the pleadings.* If the cause of action was a *derivative* one, the Debtor was an *indispensable* party and it was the duty of the court to so adjudicate from the face of the pleadings (*Carey* v. *Brown,* 92 U. S. 171), and the Court could not have dispensed with the joinder of an indispensable party (*State of Washington* v. *United States* (9th Cir.), 87 F. (2) 421). When the District Court concluded in the 77B proceedings on the face of the pleadings that the cause of action "asserted in the complaint" did not warrant the making of The Terminals Company as a party and it was not even a proper party, *it necessarily deter-*

mined that the cause of action was not a derivative one and that the action was properly commenced by the plaintiffs as creditors.

(3) Even if the action is derivative it was proper to join the Debtor in an action by creditors, and the determination that the Debtor was not even a proper party constituted an adjudication that the action was not derivative.

Even in a derivative cause of action it is not improper for creditors and the corporation to be joined as parties plaintiff (*Hanna* v. *Brictson Manufacturing Co.* (8th Cir.), 62 F. (2) 139, 144), and when the court concluded that it was not necessary to join the Debtor as a party it determined that the action was not in the Debtor and therefore it was not a proper party.

(d) Even if the cause of action belonged to the Debtor the jurisdiction was relinquished in favor of the plaintiffs as creditors, and the cause of action was properly brought by them, and the order of dismissal should be reversed.

Even if the cause of action was derivative and belonged to the Debtor which was administered under the exclusive jurisdiction in the 77B proceedings the Court in that proceeding *had the right to relinquish the jurisdiction in favor of the creditors,* and such jurisdiction was relinquished by its order that the Debtor was neither a proper, necessary nor indispensable party. The issue as to whether or not the Debtor was to be allowed to join was presented to the Bankruptcy Court upon the petition for leave to join based on the complaint, the Debtor's answer and the answer of the Bondholders'

Protective Committee representing the large group of creditors. The answer of The Terminals Company stated (R. 27):

> "that the said alleged cause of action *does not appear to offer sufficient prospects of a recovery and realization to justify the pursuit of the same by The Cleveland Terminals Building Company,* or the incurring of any expenses by The Cleveland Terminals Building Company in an effort to enforce the same."

The answer further stated:

> "If the creditors of The Cleveland Terminals Building Company, who are parties plaintiff in said suit * * * desire to pursue said cause of action on their own responsibility and at their own expense, The Cleveland Terminals Building Company does not wish to place any obstacles in their path."

The answer stated that the Debtor even consented to being made a nominal party if necessary to preserve plaintiffs' cause, provided no expense would be charged to the Debtor (R. 28).

The memorandum of the Committee *representing the creditors* stated that the cause of action clearly belonged to the creditors and not to The Terminals Company (R. 32-33). *Based on this answer and on the position of the Committee,* representing the large group of creditors, which contended that the action belonged to the creditors, the Bankruptcy Court entered its order on November 10, 1939, stating therein that the Subsidiary Debtor was neither a proper, necessary nor indispensable party. *This constituted a relinquishment of the jurisdiction, if it ever existed.*

(1) The Bankruptcy Court under 77B was authorized to relinquish its exclusive jurisdiction and permit the creditors to sue in their own name if such exclusive jurisdiction existed.

Even if the provision in Section 77B be stretched to the *absurdity,* that a *debtor* becomes the representative of the *creditor,* the Bankruptcy Court had the jurisdiction to relieve the Debtor from the conduct of such a litigation and to leave it to the creditor, which it did by the order which adjudicated that it was not a necessary or even proper party. Section 77B(c)(14) provides:

> "In case a trustee is not appointed, the Debtor shall continue in the possession of its property, and, if authorized by the Judge, shall operate the business thereof during such period, fixed or indefinite, *as the judge may from time to time prescribe,* and shall have all the title to and shall exercise, consistently with the provisions of this section, all the powers of a trustee appointed pursuant to this section, subject at all times to the control of the judge, and *to such limitations, restrictions, terms and conditions as the court may from time to time impose and prescribe."*

The Bankruptcy Court therefore was authorized to relinquish its jurisdiction.

(2) The jurisdiction was relinquished by the order that the Debtor need not be made a party.

When the application was made to the Bankruptcy Court for leave to join The Cleveland Terminals Building Company as a plaintiff or defendant and when the Court entered its order denying the right to join on the ground that *it was neither a necessary nor proper party* it thereby *limited its jurisdiction to the administration*

of the estate to the *exclusion* of the cause of action involved. The reason for the relinquishment of the jurisdiction may be due to the answer of the Debtor which stated (R. 27) that "said alleged cause of action does not appear to offer sufficient prospect of recovery and realization to justify the pursuit" by the Debtor.

In *Rosenblum* v. *Dingfelde,* 2 Cir., 111 F. (2) 407, the Court said that the abandonment of an asset by a trustee operates as if the trustee "never had title to it." If such asset was in the possession of the bankrupt and if he was discharged, the asset would not be subject to claims of creditors. Here, there was no discharge. The asset was in the possession of third parties and the creditors had the right to proceed to enforce this claim.

III.

The suit against the nonresidents in Ohio was under no possible theory an interference with the administration of the bankruptcy estate in the 77B proceedings, and if the dismissal of the cause will be sustained such cause will be forever lost to the plaintiffs as well as to the entire estate.

The cause of action accrued September 30, 1935. No action was ever taken by The Terminals Company prior to the commencement of the 77B proceeding. The Terminals Company was in business from September, 1935, when the sale was held, up to the latter part of 1936 when the 77B proceedings were invoked. After the commencement of the 77B proceedings, when it was allowed to remain in possession, *it failed to take any action on the asserted cause of action* up to the present time. Over five years have elapsed and no action was ever commenced by the Debtor. *The period of limitation in Ohio, where the cause originated, is four years.* The original action by the plaintiffs was commenced in Ohio within

the statutory period, and if it be held that the plaintiffs, as creditors, may not maintain the action, *then by virtue of the intervention of the Statute of Limitations the entire cause of action will be forever lost* (R. 41). If the Debtor be construed to stand in the position of a Trustee for creditors it was negligent and guilty of laches in not commencing the action within the period of the Statute of Limitations, and *creditors should not be prejudiced by the legal fiction which places the party* which committed the fraud in the capacity of the prosecutor on behalf of the defrauded party.

(a) Section 77B was not enacted for the purpose of permitting a corporation to initiate proceedings for alleged reorganization purposes as a means to deprive creditors of their rights and remedies indefinitely.

Section 77B was not enacted for the purpose of permitting a corporation to initiate proceedings for alleged corporate reorganization and thereby deprive the creditors of their rights and remedies indefinitely (*Re*: *Utilities Power and Light Corporation,* 7th Cir., 91 F. (2) 598). *From 1935 to 1941 no action was ever commenced by the corporation for the benefit of the creditors.* The corporate fiction ought not to be used for the purpose of depriving creditors of their rights and remedies. *In such cases the courts will ignore the corporate fiction and permit the creditors to proceed with remedy* (*Clark* v. *Miller,* 142 Pac. 918, 929 (Cal.)). The cause of action was based on a fraudulent conspiracy between the directors of The Terminals Company and the other defendants in forming the Midamerica Corporation and in acquiring the assets on September 30, 1935.

(b) The Statute of Limitations having intervened, no other cause of action may be maintained, and the cause of action will be forever lost to the entire estate.

A cause of action of this nature is not founded under the Bankruptcy Act but is founded *on the peculiar law of the State of Ohio* which adopted the theory, not uniform in all States, that directors of an insolvent corporation are trustees not for the corporation but for the creditors. The Statute of Limitations in Ohio for such a cause is four years. As against the Debtor which was a party to the fraud and which knew of all of the facts *a defense of laches may also be asserted.* A Court of Bankruptcy which is essentially a court of equity, ought not to lend its aid to permit the parties to the fraud to place obstacles in the path of creditors and to make available to such parties technical defenses. Even if there be a doubt whether the Statute of Limitations applies, the Court should not speculate with substantial rights and subject them to this doubt. Prior to the amendment of 1938 there was a conflict between the several Circuits as to whether the Statute of Limitations could be urged against the Trustee in Bankruptcy. In *Meikle* v. *Drain,* 9th Cir., 69 F. (2) 290, the Court held that the Statute of Limitations may be interposed. In *Charlesworth* v. *Hebsh, Inc.,* 8th Cir., 84 F. (2) 834, the Court also applied the Statute of Limitations against a bankruptcy trustee.

(c) The defense of laches may be available against the Debtor, and the rights of the Creditors should not be prejudiced by making such defenses available.

The defense of laches may be avaliable against a Trustee who delayed an action for over four years. *It is*

certainly available against the Debtor which neglected the cause of action for an entire year before it invoked the aid of the Court in Bankruptcy. (*Walpert* v. *Cripton,* 2 Pac. (2) 267; 213 Ga. 474; Remington on Bankruptcy, 1939 Supp., Sec. 2344, p. 55.) The defense of laches may be interposed even in bankruptcy (Remington on Bankruptcy, Sec. 2335.25).

IV.

The fraud of Midamerica Corporation was adjudicated. The recovery from the defendants is clear. The rights of the creditors should not be sacrificed on the legal fiction that the debtor instead of the creditor is entitled to maintain the action.

Subsequent to the filing of the original complaint in Indiana a Supplemental Amendment was filed by leave of court. In that Supplemental Amendment it was alleged, among other things, that after the filing of the complaint it was adjudicated in the 77B proceedings that "Midamerica" was conceived in fraud, and the "purchase" at the "Morgan" sale was in combination with the Trustees who violated their Trust. This involved the claim filed by Midamerica Corporation predicated on the purchase of notes executed by the Debtor in the amount of $13,787,000.00 at the alleged public sale at the cost to Midamerica of $887.00 and the purchase of another claim of $1,348,614.99 at the sum of $2.00 (R. 37).

These findings were made upon the objections of the appellant, A. B. Gochenour (R. 37, Par. 2). The District Court approved the Master's Report (R. 38). It follows from the foregoing findings that the creditors were defrauded, and the defendants in the Indiana suit, who are not innocent parties, but who received the spoils in excess of $6,000,000.00 from Midamerica Corporation, with notice of the facts and as parties to the fraud, are liable

to account, and the assets are charged with the trust in favor of the creditors. The Indiana defendants who joined with the fiduciaries of the Debtor to create the Midamerica Corporation, to purchase the collateral for their personal gain were jointly and severally liable for the profits realized by them from the sale of the collateral (*Irving Trust Co.* v. *Deutch*, 73 F. (2) 127, C. C. A. 2; *Ripperger* v. *Allyn*, 25 F. Supp. 554, 555; *Chappel* v. *First Trust Co.*, 30 Fed. Supp. 763, 764). This clear liability of the defendants and the assets sought to be recovered will be completely lost by the *myth* that the Debtor, which was a party to the fraud, had the right to maintain the action although it stood by and failed to take any action from 1935 to 1941. The sacrifice of the rights of the creditors predicated on this judicial myth is contrary to conscience, and we hope that this Court will remove these legal technicalities and pave the way for justice to be done, and will grant the writ.

For the foregoing reasons we respectfully submit that the Writ of Certiorari should be awarded so that the order of the District Court which was affirmed by the United States Circuit Court of Appeals for the Seventh Circuit may be reversed.

Respectfully submitted,

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(2)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

A. B. GOCHENOUR, *et al.*,
Petitioners,
v.
GEORGE AND FRANCES BALL FOUNDATION, GEORGE A. BALL AND F. B. BERNARD,
Respondents.

No. 872

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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INDEX

	Page
Opinions below	1
Jurisdiction	1
Summary of Argument	2, 3
Facts	3-7
Argument	8-26
Petitioners not real Parties in Interest	8-12
Right to sue is in Debtor	12-18
Prohibited interference with Administration of Estate	18-22
Plaintiffs' cases	22-24

TABLE OF CASES

	Page
Babbitt v. Read (C. C. A. 2), 236 F. 42	22
Case v. Los Angeles Lumber Products Co., 308 U. S. 106, 125, 126, 84 L. ed. 110, 125	12-15-19
Conway v. Bonner (C. C. A. 5), 100 F. 2d 786	24
Diversey Bldg. Corp. (C. C. A. 7), 86 F. 2d 456	23
Glenny v. Langdon, 98 U. S. 20, 25 L. ed. 43	15
Gochenour et al. v. Cleveland Terminals Building Co., (C. C. A. 6)	21-22-24-25
Gochenour v. Morgan Co., 111 F. 2d 378 (C. C. A. 6)	16
Harwood v. U. S. Shipping Board (C. C. A. 2d), 32 F. 2d 680	23
Heffron v. Duggins et al. (C. C. A. 9), 115 F. 2d 519	11
Hirschfeld v. McKinley (C. C. A. 9), 78 F. 2d 124	22
In re Greyling Realty Corp. (C. C. A. 2), 74 F. 2d 734	12-18
In re: 7000 *South Shore Drive Bldg.* (C. C. A. 7), 86 F. 2d 499	12-19
Isaacs v. Hobbs Tie & Timber Co., 282 U. S. 734, 75 L. ed. 645	12
Lewis v. Council (D. C. N. Car.), 291 Fed. 148	13
Moyer v. Dewey, 103 U. S. 301, 26 L. ed. 39	21
Seminole Securities Co. v. Southern Life Insurance Co. (D. C. N. Car.), 182 F. 85	17
Tamm v. Ford Motor Co. (C. C. A. 8), 80 F. 2d 723 726	10
Taylor v. Sternberg, 293 U. S. 470, 79 L. ed. 599	14
Trimble v. Woodhead, 102 U. S. 647, 26 L. ed. 290	15
1775 *Broadway Corporation* (C. C. A. 2), 79 F. 2d 108	23

TEXTS

Page

Glenn, Liquidation (1935), Sec. 334 12

Gerdes, Corporate Reorganizations, Chap. 9 12

Statutes

Section 110, Title 11, United States Code 9-10

Section 588, Title 11, United States Code 9

Section 207 (c), Title 11, United States Code 9-10-13

ABBREVIATIONS

A. B. Gochenour and others who were plaintiffs below will be referred to as "Petitioners";

George and Frances Ball Foundation, George A. Ball and F. B. Bernard will be referred to collectively as "Respondents";

The Cleveland Terminals Building Company will be referred to as "Terminals";

Midamerica Corporation will be referred to as "Midamerica";

O. P. Van Sweringen and M. J. Van Sweringen, will be referred to as "Van Sweringens";

J. P. Morgan & Company will be referred to as "Morgan";

Vaness Corporation will be referred to as "Vaness";

Section 77-B of the Bankruptcy Act will be referred to as "Section 77-B".

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

A. B. GOCHENOUR, *et al.*,
Petitioners,
v.
GEORGE AND FRANCES BALL FOUNDATION, GEORGE A. BALL AND F. B. BERNARD,
Respondents.
No. 872

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION

OPINIONS BELOW

The United States Circuit Court of Appeals for the Seventh Circuit rendered an opinion on January 21, 1941 (R. p. 70) 117 F. 2d 259.

The District Court filed a memorandum opinion which is reported in 35 F. Supp. 508 (R. p. 42-60).

JURISDICTION

Petitioners seek to invoke jurisdiction of this Court under Section 240 (a) of the Judicial Code as amended by

the Act of Congress of February 13, 1925 (43 Stat. 1939, 28 U. S. C. 47).

SUMMARY OF ARGUMENT

I.

The Cleveland Terminals Building Company is in reorganization in the District Court for the Northern District of Ohio, and the debtor was continued in possession. The petitioners are creditors of the corporation. Petitioners' complaint below charged a conspiracy by the respondents, who were neither officers nor directors, with others, to acquire collateral deposited by the corporation as security for the corporation's note, at a nominal and grossly inadequate consideration.

The cause of action sought to be asserted by petitioners, if one exists, which we deny, is an asset of the bankruptcy estate, and the debtor in possession is the real party in interest.

If there were a conspiracy by the respondents with others, as is alleged, fraudulently to procure this collateral, it was a wrong against the corporation, the right to the redress of which would lie with the corporation and would pass to the trustee in bankruptcy, i. e. the debtor in possession.

II.

Terminals, as is shown by the face of the complaint, was then, and is now, under the jurisdiction of the United States District Court for the Northern District of Ohio, Eastern Division (R. p. 2) in a proceeding pending therein for re-

organization under Section 77-B. By order of the District Court the debtor was continued in possession of its property. The right to sue for the alleged misappropriation of corporate property is vested solely with such corporation, it being the debtor in possession and standing in the place and stead of an ordinary bankruptcy trustee.

III.

The United States District Court for the Northern District of Ohio, Eastern Division, in which reorganization proceedings of Terminals under Section 77-B are pending, has exclusive jurisdiction over all of the assets of the bankrupt. The maintenance of this action by petitioners in the United States District Court for the Southern District of Indiana, is a prohibited interference with the orderly and proper administration of the bankrupt estate.

Once the property of a bankrupt is in the hands of the court, private rights in respect thereto are subject to the superior dominion of the court and are to be adjudged pursuant to the standards prescribed by the Congress.

The petition for the writ should be denied.

STATEMENT OF FACTS

The absence of an adequate accurate statement of the facts in the petition requires a brief statement by respondents.

Petitioners filed a complaint in the United States District Court for the Southern District of Indiana. Respondents moved to dismiss the complaint. (R. p. 9, 10.) Petitioners then filed an amendment to their complaint. (R.

p. 11, 12.) Respondents then moved to dismiss the complaint as amended (R. p. 12, 13.) Respondents filed an affidavit (R. p. 14) with certain exhibits thereto attached. (R. p. 17-34.) Petitioners and Respondents stipulated that such affidavit, with exhibits, A. B. and C attached, could be considered by the Court "in its consideration and ruling upon defendants' motion to dismiss plaintiffs' complaint." (R. p. 36.)

Petitioners filed a supplemental amendment to their complaint. (R. p. 36-38.) The Court sustained the Repondents' motion to dismiss the complaint as amended and supplemented. (R. p. 42.) A memorandum opinion was filed by the District Court (35 F. Sup. 508; R. 42-60.)

An appeal was taken by petitioners to the United States Circuit Court of Appeals for the Seventh Circuit which affirmed the District Court (117 F. 2d 259; R. 70).

Petitioners who are non-residents of Indiana, brought this class suit for themselves and other creditors of Terminals.

The complaint alleges in substance that:

(a) Terminals is in reorganization under 77B in the United States District Court in Ohio and was continued in possession of its property; petitioners are general creditors and their claims have been allowed; the action is brought on behalf of all creditors of Terminals as a class (R. p. 2, 3).

(b) In 1930 Terminals executed a collateral note and delivered the note and collateral to Vaness, which in turn delivered the Terminals note with collateral, together with

a note of its own, to Morgan; that during August, 1935, and subsequently Terminals was insolvent. (R. p. 3).

(c) Van Sweringens and Charles L. Bradley were officers and directors of Terminals; that they conspired with respondents Ball and Bernard to acquire the collateral for a nominal and grossly inadequate consideration; that pursuant to the conspiracy Midamerica Corporation was formed; that Van Sweringens and Bradley were elected officers on September 30, 1935, prior to the time fixed for the sale of the collateral; that O. P. Van Sweringen was authorized by Midamerica to purchase the collateral; that the collateral was purchased at the Morgan sale and Midamerica realized an immediate profit (R. p. 5).

(d) That the Van Sweringens and respondents Ball and Bernard agreed that the Van Sweringens were to receive 55% of the voting rights of the outstanding common stock of Midamerica under a ten-year option to purchase which expired with the Van Sweringen's death. (R. pp. 5, 6).

(e) That respondent Ball acquired 93.67% of the capital stock of Midamerica. It was thereafter transferred by him without consideration to respondent George and Frances Ball Foundation which he and respondent Bernard had organized. (R. p. 6).

(f) That on May 4, 1937, the assets of Midamerica were sold and the cash realized therefrom was distribuflted to Midamerica stockholders; that respondents should account for the sums distributed. (R. p. 7); that a receiver be appointed during pendency of cause.

(g) Petitioners filed suit in the District Court in

Ohio against Ohio residents; that it is necessary to sue respondents in Indiana to obtain personal judgment.

The amendment to petitioner's complaint (R. p. 11) alleges in substance that:

(a) The suit in Ohio is based on the same cause of action as this suit; Terminals was not made a party to the Ohio suit due to pendency of reorganization under 77B but that it should be joined as plaintiff or defendant; that a motion was made in the 77B proceedings for leave to join Terminals as plaintiff or defendant; that the matter was referred to a master who rendered his report that Terminals was "neither a necessary, indispensable or proper party" and the leave should be denied; that the court approved the report of the Master.[1]

(b) That Van Sweringen Corporation recovered a claim in excess of $27,000,000; that it knew all of the facts and thus is in a different class than petitioners; that Morgan recovered a claim in excess of $27,000,000; that it actually participated in the sale of the collateral, thus is in a different class than petitioners. (R. p. 12).

To the complaint as amended the respondents separately

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[1]The affidavit with attached exhibits A. B. and C (R. pp. 14-34) show that the recommendation of the Master was as follows: "For the reason that the petition does not allege, and no evidence has been adduced, that Subsidiary Debtor (Terminals Company) is either a proper, necessary or indispensable party in cause No. 19982, pending in the District Court ofthe United States for the Northern District of Ohio, Eastern Division. It is respectfully recommended that the petition herein be denied." (R. p. 26).

The order of court approving the Master's recommendation is based on the Master's reasons that the petition did not allege nor was there evidence adduced that Terminals was either a proper, necessary or indispensable party. (R. p. 9).

filed a motion to dismiss petitioners complaint as amended because it failed to state a claim on which any relief could be granted to the petitioners. The motion assigned the following reasons:

1. It appears from the averments of the complaint as so amended that the plaintiffs (petitioners) are not the real parties in interest.

2. It appears from the averments of the complaint as so amended that the plaintiffs are creditors of the Cleveland Terminal Buildings Company. The complaint as amended further alleges that said company is now under the jurisdiction of the District Court of Ohio in a reorganization proceeding pending under Section 77B and is in possession of its property by the order of the Court. Under the terms of the Act when a debtor is left in possession of its property in a reorganization proceeding it is vested with the same title as a Trustee in Bankruptcy would have had if one had been appointed. Terminal is, therefore, the only person who can maintain an asserted cause of action like that set forth in plaintiff's complaint. Such right to sue is vested solely in Terminal and plaintiffs have no right to maintain this action.

3. Under the provisions of the Bankruptcy Act when a reorganization proceeding is pending the court in which it is pending has jurisdiction of all assets of the bankrupt and of all claims, debts and demands due the bankrupt. The plaintiffs are therefore not entitled to maintain this action because it results in an interference with the orderly and proper administration of the bankrupt estate.

ARGUMENT.

Petitioners contend that the right of action for the alleged conspiracy by respondents with others in purchasing the collateral of the debtor does not pass to the trustee, i. e. the debtor in possession.

Petitioners assert that the decision in the instant case is in conflict with decisions of the Circuit Courts of Appeal in the Second, Fifth, and Ninth Circuits. It is also contended that the instant decision conflicts with a prior decision by the same court.

I.

The complaint shows on its face that petitioners are not the real parties in interest.

The cause of action sought to be asserted by petitioners, if one exists, is an asset of the bankruptcy estate, and the debtor in possession is the real party in interest.

It is averred that Group 3 of the collateral purchased by Midamerica was deposited under Terminals note (R. p. 4) and that Terminals delivered its note and collateral to Vaness (R. p. 3). Vaness delivered the Terminals note and collateral (with another note) to Morgan.[2] Thus the collateral securities which were purchased by Midamerica was the property of Terminals and not the property of petitioners. If there were a conspiracy by the respondents

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[2] It is averred that the notes were delivered to Morgan at the direction of defendants, the officers of said companies. (R. p. 3.) The defendants were not officers of either Terminals or Vaness nor does the complaint so allege other than in this instance.

with others, as is alleged, fraudulently to procure this collateral, it was a wrong against Terminals.

The right of action to redress the wrong would therefore lie with Terminals. Hence, if a right of action such as this passes to a trustee in bankruptcy, i. e., a debtor in possession, these plaintiffs are not the real parties in interest. Such is the applicable law.

Section 207 (c), Title 11 U. S. C. provides in part:

> "Upon approving the petition (for reorganization) . . . . the judge . . . . (1) may, ... temporarily continue the debtor in possession or appoint a trustee or trustees of the debtor's estate . . . . (2) . . . . every such trustee . . . . shall have all the title and shall exercise, subject to the control of the judge and consistently with the provisions of this section, all the powers of a trustee appointed pursuant to section 72 of this title, and if authorized by the judge, the same powers as those exercised by a receiver in equity to the extent consistent with this section . . . ."

Sec. 588, Title 11 U. S. C. provides that a debtor continued in possession, as is Terminals, shall have all the title, be vested with all of the rights and exercise all of the powers of a trustee appointed under the Bankruptcy Act.

Section 110 of Title 11 U. S. C. provides in part:

> "The trustee of the estate of a bankrupt, upon his appointment and qualification . . . . shall in turn be vested by operation of law with the title of the bankrupt, as of the date he was adjudged a bankrupt, except in so far as it is to property which is exempt, to all . . . .
>
> 6. Rights of action arising upon contracts or from the unlawful taking or detention of, or injury to, his property."

The cause of action sought to be asserted here is within the language of Sec. 110, Title 11, U. S. C. a "right of action arising from the unlawful taking or detention of or injury to" property of Terminals. Under the provisions of Section 207 (c), Title 11, U. S. C., the right of action, if any existed, passed to the debtor in possession which stands in the place of a trustee.

In *Tamm v. Ford Motor Co.* (C. C. A. 8), 80 F. 2d 723, 726, an action was brought by Tamm as a trustee in bankruptcy of Herb Ford, Inc., for damages arising out of certain false statements and inducing misrepresentations of defendant. Appellee contended that the trustee in bankruptcy, had no right to sue because the title to the chose in action did not vest in him for the reason that a trustee in bankruptcy does not take title to an action for fraud and deceit. The Court said:

> "We think Congress intended to deal fully with the title to choses in action by what it said in subdivision (6), *supra*, (Sec. 110, Title 11, U. S. C. A.) which confers title on the trustee in bankruptcy to 'rights of action arising upon contracts or from the unlawful taking or detention of or injury to his property.'
>
> "Does the cause of action here come within the language of subdivision (6), *supra*? * * * It is settled, of course, that a right of action for a purely personal tort, as for example, for damages for a personal injury, or libel, or slander, does not pass to the trustee. * * * We have not found, nor has the diligence of counsel found for us, any federal cases except *In re Gay* (D. C.), 182 F. 260, and *In re Harper* (D. C.), 175 F. 412, in which the troubling point has been passed on squarely and in favor of the trustee's title. * * * But it seems to us that the reason of the thing and the language used in subdivision (6), *supra*, largely favor the view taken

by the two District Courts in the Gay and Harper cases, *supra*, * * *

> Another clause of subdivision (6), *supra*, vests title in the trustee to rights of action arising from 'injury to his property,' i. e., the bankrupt's property. * * * And if Congress used the word 'injury' in its meaning in law, it means 'an actionable wrong', that is, an actionable wrong to property, in the abstract. * * * Surely Congress never intended that a bankrupt could lose his property to the extent of utter insolvency as here pleaded, and then go into bankruptcy for an immunity bath, and then emerge freed from his creditors and vested with all he had lost. For if the trustee has no title and therefore no right to sue, obviously, the bankrupt retains the title to the chose and may sue (*First National Bank v. Lasater*, 196 U. S. 115, 25 S. Ct. 206, 49 L. ed. 408), and the action here must then be allocated to the category of a personal injury to a corporation. We are therefore constrained to follow the cases of *In re Gay* and *In re Harper*, both *supra*, and hold that the trustee in bankruptcy took title to the chose in action here and that he had the right to bring and maintain this suit."

(Compare *In re Bothe* (C. C. A. 8), 173 Fed. 597, 600.)

Heffron v. Duggins, et al. (C. C. A. 9), 115 Fed. 519, 520.

The collateral deposited with Morgan as security for the note was the property of Terminals and remained the property of Terminals until sold by Morgan pursuant to the terms of the note and upon default in payment thereof. If the note had been paid when it fell due, there would have been no necessity for resort to the collateral and in that event the collateral security would have been returned to Terminals as its property. Thereafter, if Terminals had filed its petition under Section 77B, it cannot be gainsaid that said collateral would then be property of the estate, the title to which would have passed to the debtor in possession.

These plaintiffs now seek not the collateral but a money judgment representing such collateral less the price paid by Midamerica. Clearly the alleged injury was an injury to Terminals property. The right of action for such alleged injury lies with Terminals alone. Any right in or to the collateral which these plaintiffs may have is a derivative right flowing to them through Terminals as its creditors.

That the title and right to possession of all property owned and possessed by the bankrupt vests in the trustee is clearly settled and the bankruptcy court has exclusive jurisdiction to deal with the property of the bankruptcy estate.[3]

The petitioners are not the real parties in interest so as to successfully maintain a cause of action such as they have asserted.

II.

Terminals, being now under the jurisdiction of the United States District Court in Ohio, (R. p. 2) in a reorganization proceeding under Section 77B, and being in possession of its property by order of that Court, the right to sue for the alleged misappropriation of corporate property is vested solely in the debtor in possession which stands in the place of an ordinary bankruptcy trustee.

As has been pointed out, a debtor in possession by

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[3] *Case v. Los Angeles Lumber Products Co.*, 308, U. S. 106, 125, 126, 84 L. ed. 110, 125 (see also foot note 22, p. 125).

Isaacs v. Hobbs Tie & Timber Co., 282 U. S. 734, 737, 75 L. ed. 645, 661, 662.

In re Greyling Realty Corporation (C. C. A. 2), 74 F. 2d 734, 736.

Glenn, Liquidation (1935) Section 334.

Gerdes, Corporate Reorganizations, Chap. 9.

7000 South Shore Drive Bldg. (C. C. A. 7), 86 F. 2d 499.

Section 207 (c) Title 11, U. S. C. is vested with the title to the bankrupt's property exactly as a trustee is under the old bankruptcy section 110 (6), Title 11, U. S. C.

In *Lewis v. Council* (D. C. N. Car.), 291 Fed. 148, 157, it was said:

> "By section 70, Bankruptcy Act (Comp. St. Sec. 9654), the trustee of a bankrupt, either personal or corporate, is 'vested by operation of law with the title of the bankrupt, as of the date he (or it) was adjudged * * * to all * * * rights of action arising upon contracts * * * or injury to, his (or its) property.'

"In *Trustee, etc v. Bossieux,* 3 Fed. 817, District Judge Hughes (E. D. Va.) held that the trustee in bankruptcy was vested with the right to bring suit in equity against the directors of a bank in bankruptcy to recover losses incurred by the gross negligence of such directors.

* * *

"The basis upon which suits by trustees in bankruptcy or receivers of insolvent corporations are sustained is that the assets of such bankrupts or insolvent corporations are trust funds to be administered by the court for the benefit of all of the creditors and stockholders. This includes rights of action for the recovery of such assets as may have been lost, misapplied, or wasted by the officers of corporations.

* * *

"In *Kelly v. Dolan* (C. C. A. 3d Cir.), 233 Fed. 635, 147 C. C. A. 443, it was held that when a corporation is injured

through the negligence of its directors, the right to recover for such negligence is vested in the corporation. It appearing that a receiver had been appointed of the property of the insolvent corporation, the bill brought by the stockholders was dismissed.

"In *Klein v. Peter* (C. C. A. 8th Cir.), 284 Fed. 797, Keyon, Circuit Judge, said:

> 'The property of the corporation, which would include claims of action on behalf of the corporation is in possession and custody of the court, held by the receiver as an officer of the court, * * * the right of action by the receiver * * * is exclusive.' *Klein v. Peter* (C. C. A. 9th Cir.), 286 Fed. 362."

Compare: *Central Hanover Bank & Trust Co. v. Philadelphia & Reading Coal & Iron Co., et al.* (C. C. A. 3), 99 F. 2d 642, 645, 646; *Taylor v. Sternberg,* 293 U. S. 470, 472, 79 L. ed. 599, 602.

In *Gross v. Irving Trust Company,* 289 U. S. 342, 344, 77 L. ed. 1243, 1244, the Court said:

> "Upon adjudication of bankruptcy title to all the property of the bankrupt wherever situated vests in the trustee as of the date of filing the petition in bankruptcy. The bankruptcy court has exclusive jurisdiction, and that court's possession and control of the estate cannot be affected by proceedings in other courts, state or federal. * * * Such jurisdiction having attached, contrary to the administration of the estate cannot be surrendered even by the court itself. * * * 'The filing of the petition is a caveat to all the world and in fact an attachment and injunction.'"

Before the enactment of Section 77B there are many

cases which announce the rule that after the adjudication in bankruptcy and the appointment of a trustee, no creditor has the right to institute legal proceedings to set aside a transfer or conveyance alleged to have been fraudulent as that right pertains to the trustee alone.

Glenny v. Langdon, 98 U. S. 20, 25 L. ed. 43;
Trimble v. Woodhead, 102 U. S. 647, 26 L. ed. 290.

In *Case v. Los Angeles Lumber Products Co.,* 308, U. S. 106, 125, 84 L. ed. 110, 125, this Court said:

> "Once the property is in the hands of the court private rights as respects that *res* are subject to the superior dominion of the court and are to be adjudicated pursuant to the standards prescribed by the Congress. As a result of such proceedings the hand of all *executions or levies may be stayed.* The court acquires '*exclusive jurisdiction of the debtor and its property wherever located for the purposes of this section.*' The court need not keep the debtor in possession but may substitute for the old management a trustee; or if the old management is retained it operates the business 'subject at all times to the control of the judge, and to such limitations, restrictions, terms, and conditions as the judge may from time to time impose and prescribe.' Thus, while the property remains in the hands of the court, as it does until dismissal or final decree on confirmation, the debtor, though left in possession by the judge, does not operate it, as it did before the filing of that petition, unfettered and without restraint. The control of the court is then pervasive." —(our emphasis).

In the amendment to their complaint (R. p. 11) petitioners assert they are in a special class distinct from the Van Sweringen Corporation and Morgan, two other creditors of Terminals, because both had participated or were parties to the acquisition of the property by Midamerica.

The conclusive answer to this assertion is that the District Court in Ohio having jurisdiction of the debtor, has not placed the petitioners and those for whom they sue, in a separate class. Orderly administration under 77B requires that the bankruptcy court have *exclusive* jurisdiction of the classification of creditors.

In *Gochenour v. Morgan Co.*, 111 F. 2d 378 (C. C. A. 6), while holding that portion of the claim in the amount of $5,000,000 is secondary to the rights of other creditors of Terminals, the Court of Appeals affirmed the allowance of the balance of a claim of J. P. Morgan & Co. as against this debtor in the amount of $22,000,000 as a general creditor. The bankruptcy court has heretofore classified the creditors and taken preliminary steps looking toward ultimate distribution of the assets. The District Court of Indiana, if it assumes jurisdiction of petitioners' action and adjudicates the alleged cause of action sought to be asserted, would have to pass upon the validity of the action of the bankruptcy court in the classification of creditors. If a recovery were to be had by petitioners in this asserted cause of action, any sums recovered would have to be distributed by the District Court of Indiana, thus usurping the function of the bankruptcy court. Either to classify the creditors or to make distribution of assets would nullify the action of the bankruptcy court and overturn or disregard the classification of the creditors made by such court.

The contentions of petitioners in their complaint will not withstand analysis. In their original complaint they say they "are general creditors together with other general creditors of the Terminals Company * * *" (R. p. 2). On November 16, 1939 (R. p. 10), after respondents' motion to dismiss had been filed on October 27, 1939 (R. p. 9), petitioners filed an amendment to their complaint (R. p. 11).

In substance the amendment alleged that the Van Sweringen Corporation (R. p. 11) and J. P. Morgan & Co. (R. p. 12) stood in a different class than petitioners because both companies had participated or were parties to the acquisition by Midamerica of the property.

The fact that the amendment was made was a recognition by petitioners that any suit which was brought on behalf of the general creditors of the debtor must necessarily be brought by the debtor and the attempt was to create a special class which petitioners could represent.

Petitioners efforts to create this special class by excluding J. P. Morgan & Company and the Van Sweringen Corporation from participation in any recovery which might be made in this case must fail for two reasons:

> First. The Ohio Bankruptcy Court has held that Morgan & Company and the Van Sweringen Corporation are general creditors with large claims which have been allowed and that court only can determine who shall participate in funds of the bankrupt.
>
> Second. A "class" must have some general characteristics in common. In many cases reference is made to a class suit as one "in which one or more members of a numerous class having a common interest may sue in behalf of themselves and all other members of the class. * * * Such suits are sometimes called 'creditors' suits' and sometimes * * * 'stockholders' suits'." *Seminole Securities Co. v. Southern Life Insurance Co.*, (D. C. N. Car.) 182 F. 85, 96.

Notwithstanding the averments of the complaint as amended it is still clear that not only petitioners but J. P. Morgan & Company and the Van Sweringen Corporation are *general creditors* of the bankrupt. They thus

have a common characteristic and the claim that J. P. Morgan & Company and the Van Sweringen Corporation are estopped to participate in the distribution of the fund merely presents a question of whether one member of the class because of individual action on his part has forfeited his right to participate in a fund. He still remains a general creditor and between him and petitioners there is no legal difference of position.

Petitioners seek to bring a "class suit" for the general creditors of Terminals. The right of action which they seek to assert, if any exists, is a corporate asset and belongs now to the trustee (the debtor in possession).

III.

The District Court of the United States in Ohio, in which reorganization proceedings of Terminals under Section 77B are pending, has jurisdiction over all of the assets of the bankrupt and the maintenance of this action by petitioners in the Indiana District Court is a prohibited interference with the orderly and proper administration of the bankrupt estate.

As has been pointed out in the case of *In re Greyling Realty Corporation,* (C. C. A. 2) 74 F. 2d 734, 736:

> "The apparent purpose of Section 77B of the Bankruptcy act, which provides for proceedings in the reorganization of a corporation and its subsidiaries, is to avoid immediate liquidation of the properties involved and to rehabilitate rather than liquidate * * * Section 77B was planned to bring such proceedings within the paramount and exclusive jurisdiction of one bankruptcy court. It was intended to provide a centralization of administration. * * * Indeed one of the principal reasons given for the enactment of Section 77-B was

> to eliminate the necessity of costly ancillary proceedings."

In *Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106, 84 L. ed. 22, 34:

> "Once the property is in the hands of the Court private rights as respects that *res* are subject to the superior dominion of the court and are to be adjudicated pursuant to the standards prescribed by Congress. * * * The Court acquires 'exclusive jurisdiction of the debtor and its property wherever located for the purposes of this section'."

In the administration of such a statutory plan as lies behind the purpose for the enactment of Section 77B the whole purpose of the Congress would be defeated if creditors such as petitioners assert themselves to be, could resort to courts other than the bankruptcy court for the recovery and distribution of assets. Nothing but chaos and confusion in the administration of the estate could result from a pursuance of the unauthorized course which petitioners are attempting to pursue.

In the case of *In re 7000 South Shore Drive Building Corporation*, (C. C. A. 7) 86 F. 2d 499, 501, it is said that:

> "True it is that, upon the filing of the petition under section 77B the approval of the same, exclusive and paramount jurisdiction over the *res* of the estate passed to the court of bankruptcy, which thereafter had the unimpeded right—indeed, the obligation—to draw unto itself the power of disposition of all controversies relating thereto. *Isaacs v. Hobbs Tie & Timber Co.*, 282 U. S. 734, 51 S. Ct. 270, 75 L. ed. 645; *In re Sterba*, 74 F. (2d) 413 (C. C. A. 7); *Gross v. Irving Trust Co.*, 289 U. S. 342, 53 S. Ct. 605, 77 L. ed. 1243, 90 A. L. R. 1215. This power being vested exclusively in the national courts, under the grant from the states in the Federal Consti-

> tution, those courts may not be impeded or interfered with in discharging their duties pursuant to legislation enacted by Congress under the bankruptcy power, in respect to anything pertaining to the administration of the assets."

The chaotic condition of the administration of the bankruptcy estate cannot be over-estimated if creditors such as petitioners are permitted to maintain actions after a debtor corporation has taken steps under Section 77B to reorganize. In the instant case petitioners asked for the appointment of a receiver during the pendency of the cause and to take charge of all the property belonging to the trust estate. Petitioners, so the complaint alleges, have already filed their claims in the reorganization proceedings and such claims have been allowed. (R. p. 2). The District Court in Indiana could not know the extent of the claims except in so far as the complaint alleges. It is at once apparent that the Indiana District Court does not have authority to classify the creditors of Terminals which is in reorganization proceedings in the United States District Court in another state, nor has it authority to distribute proceeds of any recovery that might be made. The bankruptcy court is the proper one to classify the creditors and distribute the assets. To avoid such a chaotic administration as would ensue, the Congress has given to the bankruptcy court exclusive jurisdiction over the assets of the estate wherever they may be found, and has given it the sole and exclusive authority to make distribution of such assets as such bankruptcy court shall direct.

No question is presented here respecting the abandonment by the trustee of any cause of action against these respondents which it might have. No allegation is made that the trustee has either failed or refused to bring an action such as is asserted by petitioners. However, even though

the trustee, i. e., the debtor in possession, had refused or failed, such right would not by reason therof pass to petitioners.

In *Moyer v. Dewey,* 103 U. S. 301, 26 L. ed. 39 it was pointed out that the refusal or failure of a trustee in bankruptcy to sue for the avoidance of an alleged fraudulent conveyance within the time prescribed by law or at all, does not transfer the right to any creditor or to the creditors generally or authorize them to sue in their own behalf.

The remedy of creditors who are dissatisfied with refusal or inactivity of the trustee is to apply to the court of bankruptcy for an order directing the trustee to institute the necessary proceeding. If the court is satisfied that such action should be taken and will probably result in benefit to the estate, it has power to require the trustee to proceed.

In *Gochenour et al v. Cleveland Terminals Building Co.* (C. C. A. 6) decided March 3, 1941, it was pointed out that it is not the purpose of the Act to furnish immunity to wrongdoing by corporate officers, but that, on the contrary, it was the plain duty of the court to direct the investigation of all substantial allegations for mismanagement or fraud, and that "under the Act, if a corporate debtor is continued in possession of its assets, the judge may at any time, appoint a disinterested person as an examiner to perform the duties imposed upon a trustee * * *.

"The remedy of a creditor, if aware of the existence of property or credits which should readily go to the debtor for the benefit of creditors, is to inform the court of the facts and request that the trustee or debtor be required to proceed by suit, if necessary, to recover the property. *Trimble v. Woodhead,* 102 U. S. 647, 650."

The Congress foresaw the probable results of such haphazard administration of bankruptcy estates. It thus gave to bankruptcy courts the exclusive jurisdiction over the assets of a bankruptcy estate wherever they may be found.

The settled law is against the petitioners.

IV.

On the propositons on which this case was decided and appearing hereinabove there is no conflict among the decisions of the various circuit courts of appeal as is asserted by petitioners. None of the cases relied on by petitioners (pet. p. 7) hold contrary to the principles asserted here as we show:

In *Hirschfeld v. McKinley* (C. C. A. 9), 78 F. 2d 124, it was pointed out that if any creditor of the Drug Company in reorganization had been defrauded by the misrepresentation of the real capital of the company, the wrong done to him cannot entitle the entire body of creditors who have not suffered from the fraud to recover from the entire body of stockholders who took no part in the fraud. No such case is presented here. Petitioners and those for whom they sue are all general creditors.

> See *Gouchenour et al. v. The Cleveland Terminals Building* Co. (C. C. A. 6) (Decided Mar. 3, 1941).

In *Babbitt v. Read* (C. C. A. 2), 236 F. 42, certain bondholders claimed to have been defrauded by misrepresentations of stockholders. The court pointed out that it was only such defrauded purchasers "and not the trustee, who have the right to assert such a claim." The alleged fraud in the instant case was against Terminals.

In *Harwood v. U. S. Shipping Board* (C. C. A. 2), 32 F. 2d 680, Topping Brothers sought to intervene in a trustee's suit to set aside a contract of settlement between the bankrupt corporation and another. It was pointed out that Topping Brothers did assent to the lifting of a state court receivership which permitted the contract of settlement to be made. The Court said:

> "But, since its indebtedness had not been paid, it is still a creditor, whose interest, with other creditors, is protected by the trustee in bankruptcy, who represents all creditors."

The interest of petitioners is protected by the trustee (i. e. the debtor in possession).

In 1775 *Broadway Corporation* (C. C. A. 2), 79 F. 2d 108, the debtor was the Broadway Corporation. The claims asserted were against the Manufacturers' Trust Co. for misrepresentation in selling certain notes. The Court pointed out that:

> "Claims arising from misrepresentation in the sale of notes were not claims against the debtor or its assets nor claims that must be settled in order to bring property into the reorganized company * * *"

There is nothing in the case analogous to the case at bar.

In *Diversey Bldg. Corp.* (C. C. A. 7), 86 F. 2d 456, 457, the question was whether a District Court had power to release a guarantor from his guaranty of a bond issue of a debtor in reorganization by reason alone of the debtor, not the guarantor, being in the bankruptcy court. The case is not in point with the case at bar.

Conway v. Bonner (C. C. A. 5), 100 F. 2d 786, was a suit by a trustee to recover from a director of bankrupt certain shares of stock in other corporations obtained by director in exchange for the directors shares of stock in the bankrupt. The court followed the Texas law and found the corporation not insolvent at the time of the exchange.

The Court then said:

> "It follows that appellant has not sustained his alleged right of recovery in the right of the creditors."

This opinion indicates accord with the decision at bar and not conflict as petitioners assert.

Petitioners Contentions Without Merit

The Circuit Court of Appeals for the sixth circuit has decided against the petitioners the same contentions they make here.

In *Gochenour, et al. v. Cleveland Terminals Building Co.* (C. C. A. 6), decided March 3, 1941, petitioners and two other creditors of Terminals filed a motion in the bankruptcy court asking that a restraining order entered at the time of the bankruptcy adjudication be modified to the extent that said creditors could continue to prosecute an action therefore commenced in the Common Pleas Court of Cuyahoga County, Ohio, which sought to recover damages from the directors of Terminals for alleged misfeasance and fraud in the management of the affairs of the corporation.

The Court referred to the present action which was instituted in Indiana, and then said in respect thereof, that:

"The grounds for recovery and relief prayed were identical with those asked in their action in the District Court."

In holding that the alleged cause of action sought to be asserted by Gochenour and others was an asset of the corporation and thus passed to the trustee, i. e. debtor in possession, the Court said:

> The right of action of a corporation to recover damages because of the misconduct and neglect of duty of a corporate officer passes to the trustee of a bankrupt corporation. Officers of corporations, although not responsible for errors of judgment, are fiduciaries charged with the duty of caring for its property and of managing its affairs honestly and in good faith. If this duty has been so violated as to result in the impairment of assets, or loss of property, or an officer, by misconduct, makes a profit for himself at the expense of the corporation, he may be compelled to make full restitution (*Geddes v. Anaconda Mining Co.*, 254 U. S. 590, 599; *Irving Trust Co. v. Deutsch*, 73 F. (2d) 121 (C. C. A. 2), and as the corporation could have maintained a suit for reimbursement from its officers for misconduct, the right of such an action was an asset of the company and passed to the trustee in bankruptcy.
> * * *
>
> Authority for a creditor to bring suit to recover property or rights of property of a corporation in bankruptcy reorganization under any circumstances is not found in the Act. Pending such proceedings, the assets of the debtor are in *custodia legis* and neither it, nor its creditors, has any right to sue on its behalf except as directed by the court. (*Glenny v. Langdon*, 98 U. S. 20, 30.)
>
> The remedy of a creditor, if aware of the existence of property or credits which should rightly go to the debtor for the benefit of creditors, is to inform the court of the facts and request that the trustees or debtor be required to proceed by suit

if necessary to recover the property. *Trimble v. Woodhead*, 102 U. S. 647, 650."

It is clear that the decision of the United States Circuit Court of Appeals for the Seventh Circuit in the instant case announced the well settled applicable legal principles universally accepted.

It is respectfully submitted therefore that petitioners' petition for a writ of certiorari should be denied.

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Supreme Court of the United States

OCTOBER TERM, A. D. 1940

No. 872

A. B. GOCHENOUR, et al.,

Petitioners,

vs.

GEORGE AND FRANCES BALL FOUNDATION, GEORGE A. BALL and F. B. BERNARD,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITIONERS' REPLY BRIEF

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INDEX.

PAGE

I. The Complaint shows that the Petitioners are the real parties in interest to maintain the action 3

II. The jurisdiction of the res is no bar to the action in personam 6

III. The action between creditors and third persons for a wrong to them is not an interference with the administration of the 77B proceedings..... 12

IV. The decision of the different circuits are irreconcilable 14

ADDITIONAL CASES CITED.

Bickford v. Fed. Res. Bank, 5 Fed. Supp. 875..... 19

Beach v. Williamson, 83 So. P. 860..... 8

City of Fort Worth v. National Park Bank, 261 Fed. 817 5

Kitchen v. Conover, 22 F. (2) 116..... 5

Van Sweringen v. Van Sweringen, C. C. H. Bankruptcy Service, Par. 53,126 2

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PETITIONERS' REPLY BRIEF

The conspiracy to defraud the creditors was adjudicated by the Sixth Circuit since the filing of the petition.

In their "summary" of the argument (p. 2) counsel still *deny* the facts pertaining to the conspiracy. Of course, their denial cannot be considered in view of their motion to dismiss on jurisdictional grounds, whereby they have admitted the sufficiency and truth of each allegation. (*Bickford* v. *Fed. Res. Bank,* 5 Fed. Supp. 875.)

The petition showed (p. 3) that the bankruptcy court had adjudicated the conspiracy to defraud the creditors in the purchase of assets at the price of $889.00, and the attempt to recover in the reorganization proceed-

ings $15,135,614.99. This was the same sale at which assets involved in the instant case were purchased for $318,000.00 and later yielded about $6,000,000.00. Since the filing of the petition the United States Circuit Court of Appeals for the Sixth Circuit, in its opinion rendered on April 16, 1941, *adopted the findings set forth in the petition,* at page 3, and adjudicated that there was a *fraudulent conspiracy* in the purchase by Midamerica (see *In Re Van Sweringen,* Case Nos. 8646, 8654 and 8655, decided by the Sixth Circuit and not yet officially reported).* Among other things the opinion stated:

> "From the manner and under the circumstances in which, in association with outside enterprises,** the Van Sweringens, as directors of insolvent corporations, purchased these claims against their *cestui que trustent,* the debtors herein, at substantially less than real values. Equity and good conscience demand that the claims of the corporate creature, Midamerica, be limited to the amounts actually paid by it for the notes and bonds of the insolvent corporations."

The Court also said:

> "It seems soundly settled that one who knowingly joins a fiduciary in purchasing for profit the property of the trust estate in unlawful circumstances becomes jointly and severally liable with him for resultant profits."

It further said:

> "It is apparent here that the cupidity of persons in a fiduciary position has caused them to serve themselves in preference to those whom it was their duty to serve. Such dereliction is forbidden by just principles of law."

The only comment we can make is that *the same principles of law which were employed to deny $15,000,-*

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* See C. C. H. Bankruptcy Service Report 80 of April 23, 1941, Par. 53,126.

** The respondents here.

000.00 in claims to the respondents * should have equally been applied to cause them to disgorge the $6,000,000.00 in profits involved in this suit. If the action of the petitioners will be defeated on the technicality urged by the respondents the entire cause of action will be lost to the creditors, as the Statute of Limitations has expired.

I.

The complaint does not show on its face that the plaintiffs are not the real parties in interest, but on the contrary it shows that the plaintiffs are the real parties in interest, and the Debtor was either a nominal or proper party but not an indispensable party.

The contention (p. 8) that the complaint "shows on its face" that the cause of action is not in the plaintiffs is *contradicted by the allegations of the complaint.* They cannot by their motion to dismiss *supply a different cause.* (*Railway Express Agency* v. *Jones,* 106 F. (2) 341.) The complaint *did not allege* (as they contend) *that the corporation was defrauded.* On the contrary, it alleged (R. 3) that the officers and directors of the corporation *became "Trustees" for the "creditors"*; that as such Trustees "it became their duty to exert every effort" for the "creditors" and to notify *them* of the sale so that they might protect "their interest." It alleged that in *"violation of their duty and for the purpose of defrauding the creditors"* the defendants "conspired to acquire the collateral"; that by reason of the combination of the defendants with the directors of the corporation "to deprive the *creditors"* of the "benefits," and by "their failure to inform the creditors of their secret agreement" the defendants became liable to the *creditors.* It alleged that the of-

* This was done at the instance of the petitioners after the Debtor, the alleged trustee for the Creditors, admitted the validity of the claim.

ficers and directors of the corporation "never informed plaintiffs or any of the other general creditors of their acts and never afforded them an opportunity to bid at the sale." It prayed among other relief (R. 7) that it be decreed that the defendants "acquired the above securities and assets as Trustees" for the "creditors." The original complaint was framed on the theory that *all* existing creditors were entitled to such relief. The amendment *changed the cause of action to a distinct class* of creditors (R. 11).

It is therefore apparent *from the "face" of the complaint* that the cause as *alleged* was *available to creditors* and *not* to the corporation. The gist of the action was conspiracy to acquire the assets, without informing the creditors of the scheduled sale, and without giving *them* the opportunity to bid at the sale. It pivoted on the theory that *after insolvency the directors were trustees solely for the creditors* and *not* for the stockholders, and their trust duty was directly to the creditors. *No charge of fraud and no fraud was committed on the insolvent corporation which knew all of the facts and which was in no position to bid.** The corporation could not assert fraud when it knew of the scheduled sale, and it was in no position to bid. *The only persons against whom fraud was committed are the creditors who were in a position to bid and who were deprived of such opportunity.*

It is urged (pp. 8-9) that this is a derivative action because the collateral "was the property" of the corporation and not of the creditors and the conspiracy to procure the collateral "was a wrong against the Terminals" and therefore it is asserted that the right of action "would therefore lie with Terminals."

---

* This is particularly true in view of the fact that this was a "one family corporation" (*Pepper* v. *Litton*, 308 U. S. 295) and the Van Sweringens merely used the corporations as an instrumentality as held in the former appeal by these appellants. (*Gochenour, et al.* v. *J. P. Morgan & Co.*, 111 F. (2) 378.)

The complaint did *not allege* that at the date of the conspiracy *the collateral was the property of the Terminals.* On the contrary, it alleged (p. 3) **that at the date of the conspiracy the corporation was insolvent and the corporation and its directors were then trustees for the creditors only; that as such trustees it was their duty to notify the creditors of the scheduled sale and to give them the opportunity to protect their interest and to bid at the sale;** that they violated their duty and by reason thereof *the creditors were defrauded,* and the collateral was acquired by the defendants. This was not a charge that the corporation was then the owner of the collateral. The charge was that by reason of the trust the creditors had an interest to the extent of bidding at the sale to acquire the collateral for their benefit. **The theory of the case** was not that the defendants were trustees for the corporation and that the corporation was defrauded, but **that the directors and the corporation were trustees for the creditors and that the creditors were defrauded.**

This was not a suit to set aside the sale of the collateral and to have the collateral returned to the corporation. It was a suit based on breach of trust to the creditors only. *The primary cause of action was failure to afford to the creditors the opportunity to bid at the sale.* It was a cause wherein the creditors only are interested and no one else. While the corporation might have been a proper party it was not an indispensable party. The right of creditors to maintain such an action was held to exist in *City of Fort Worth* v. *Nat. Park Bank,* 261 Fed. 817, 819, and in *Kitchen* v. *Conover,* 22 F. (2) 116.

Discussion of respondents' authorities:

The quotation (p. 10) from the *Ford Motor* case (80 F. (2) 723) is not in point. This case holds that *if a*

bankrupt has a cause of action the cause of action passes to the trustee in bankruptcy. The cause of action in the instant case was not vested in the corporation which was not defrauded, and the case is therefore inapplicable.

The *Isaacs* case (282 U. S. 734) which they cite (p. 12) involves property of the bankrupt, and the Court held that the trustee in bankruptcy was vested with the title no matter where the bankrupt's property was located. It is evident that it has no application on the issues involved here. The quotation from Glenn on Liquidation is not in point for the reason that it was predicated on the doctrine that directors of a corporation after insolvency are not "in the strict sense" in a fiduciary position which was adopted by many jurisdictions *outside of* Ohio. The Ohio courts have adopted the contrary view holding that directors of an insolvent corporation are in a strict sense trustees for creditors only. (*Young Love* v. *Lime Co.*, 49 O. S. p. 663.)

The *Greyling* case (74 F. (2) 734) simply decided that where a receiver was in possession of the assets of the corporation that upon the appointment of a trustee under Section 77B the trustee succeeds to the rights of the receiver. This has no remote application to the instant case.

II.

The jurisdiction of the res under 77B is no bar to this action.

We discussed the question (pp. 19-29) whether the jurisdiction of the *res* under 77B was a bar to the action for fraud by *cestui que trustent* against their trustees and for fraud against third parties and have shown that the Bankruptcy Court was only concerned with the administration of the *res* and with no other causes of action. Instead of answering our brief they quote from

many decisions, *none of which have the slightest application to the point involved.*

Even in cases where the Debtor has some interest, yet where the suit involves third persons the jurisdiction under 77B is not exclusive, for "Congress did not intend the Bankruptcy Court under Section 77B to take over all litigation between the Debtor and third persons." (*In Re Adolph Gobel, Inc.*, 80 F. (2) 849; *Re Prudence Bonds Corporation*, 75 F. (2) 262; *Thompson* v. *Terminal Shares, Inc.*, 104 F. (2) 1, 9.)

Authorities Not in Point:

The quotation (p. 13) from the *Lewis* case (291 F. 148) merely holds that a Trustee in bankruptcy is vested with the title of the bankrupt, a point not in issue. The *Trustee* case (3 F. 817) merely decides that a trustee in bankruptcy may bring action in the name of a bank for losses caused by the directors to the bank, a question not in issue here. The *Kelly* case (233 F. 635) decided that "when a corporation is injured through the negligence of its directors, the right to recover for such negligence is vested in the corporation." The injury here was not to the corporation but to the creditors who were not given the opportunity to bid at the sale and to protect their interest.

The *Klein* case (284 F. 979) merely decided that a receiver of a corporation has the exclusive right of action concerning property belonging to the corporation, a question not involved in this case.

The *Central Hanover Bank* case (99 F. (2) 642) is also not in point. All that that case decided was that a mortgagee need not make application to sequester the rents after intervention in bankruptcy.

The *Gross* case (289 U. S. 342), and the *Taylor* case (293 U. S. 470) cited by them (p. 4) simply state the

general proposition, which is not disputed, that a Bankruptcy Court has exclusive jurisdiction of the bankrupt's property. To the same effect is the *Trustee System* case (85 F. (2) 467). Counsel cite (p. 15) *Glenny* v. *Langdon,* 95 U. S. 20, and *Trimball* v. *Woodhead,* 102 U. S. 647, on the proposition that prior to the enactment of 77B the rule existed that after jurisdiction in bankruptcy and the appointment of a trustee no creditor has a right to institute legal proceedings to set aside a transfer or conveyance. It seems that counsel are of the impression that plaintiffs' complaint was to set aside the sale of the collateral. If the corporation was in a position to set aside the sale of the collateral on the ground of fraud against it, then, of course, the trustee in bankruptcy would succeed to such right. Under no theory of law could the corporation seek to set aside the sale of the collateral. The suit in the instant case is not a suit to set aside the sale of the collateral but a **suit for loss caused to the creditors for failure to inform them of the sale and to offer them the opportunity to bid at the sale and protect their interest founded on the doctrine that the corporation and its directors and officers were then trustees for the creditors.**

In *Beach* v. *Williamson,* 83 So. 860, the Supreme Court of Florida stated:

> "Officers of an insolvent corporation may have the right to buy the assets and properties of the corporation, but only after they have made a clean statement, to those most concerned, as to their beliefs concerning the value of the properties and possibilities for liquidation, to the end that the transaction may be kept free from possibilities of double dealing."

In the instant case the Van Sweringens controlled the parent and the Subsidiary. To whom were they to make this clean statement? Certainly not to themselves. It

was to the creditors that they owed this duty, and it is the creditors who have the right to maintain the action.

The decision in the *Los Angeles Lumber Products Co.* (308 U. S. 106) cited in their brief (p. 15) does not bear out their contention that the acquisition of jurisdiction over the *res* vests the Bankruptcy Court with jurisdiction over a cause of action by creditors against *third parties.* In the first paragraph which they quote the Court said:

> "Once the property is in the hands of the court, *private rights as respects that res* are subject to the superior dominion of the court and are to be adjudicated pursuant to the standards prescribed by Congress." (Italics ours.)

It is apparent that the Court confines the jurisdiction to *"rights as respects that res"* and no other rights.

Showing of Standing in a Distinct Class:

Counsel admit (p. 15) that petitioners alleged that they belonged to a "special class." They say that (p. 15) their "conclusive answer to this assertion is" that the Bankruptcy Court has not placed them in a different class and they cite the *Morgan* case. They seem not to be cognizant of the fact that they cannot contradict the complaint *by their motion.* They also lost sight that their motion to dismiss, based on jurisdictional grounds, constituted an admission as to the sufficiency of each allegation. (*Bickford* v. *Fed. Res. Bank,* 5 Fed. Supp. 875.) It was charged in the complaint (R. 11) that the "parent" which has a claim of $27,104,105.28, was not entitled to the relief due to the fact that the "parent" was a party to the fraud and knew of the facts and circumstances and is in a different class. It further alleged (p. 12) that J. P. Morgan & Co. has a claim of $27,777,718.27, but due to the fact that it actively par-

ticipated in the acquisition of the assets by Midamerica and knew all of the facts it stands in a different class and is not entitled to the relief.

If they wanted to deny the allegations of the complaint their proper denial could only have been made by an answer but not by a motion which admitted the truth of the allegations. A reference, however, to the reported case, *Gochenour* v. *J. P. Morgan & Co.* (111 F. (2) 378), which they say established that creditor in the same category as all other creditors, will show that the assertion is incorrect. *In that case the Court held that to the extent of $5,000,000, plus accrued interest from* October 1, 1931, to the date of the filing of the claim in 1936 the claim *was fraudulent* and as to that phase *the claim should be disallowed as to bona fide creditors.* The Court there said:

> "But, aside from inferences as to the value of the stock when purchased, and as to claimant's confidence in the Van Sweringen enterprises, the money was advanced at least partially upon the credit of C. T. B. which **we regard as but an instrumentality of Van Sweringen Corporation, by which it was owned** directly, and of **Vaness, by which it was owned indirectly.** Claimant knew this and we think it should share responsibility for a loan based upon the credit of a corporation which had **no independent voice** in its management, but which had **separate and independent creditors** who might be **adversely affected** thereby. C. T. B. bought the stock for five million dollars with option in Van Sweringen Corporation to repurchase it for the same amount on or before May 1, 1935. Assuming that it was worth six million dollars, it was beyond C. T. B.'s power to benefit thereby, and in addition, it was obligated to pay interest up to $1,350,000.00 on the money it had borrowed to make the purchase. If the option were exercised it was 'out' the interest. Van Sweringen Corporation might not exercise its option, but this contingency was beyond C. T. B.'s control.

> We think all evidence justifies, if it does not compel, the conclusion that claimant knew all this and that its own interest in the transaction was such as to **tinge it with fraud** toward C. T. B.'s creditors. (Bold type supplied.)
>
> Our holding and decree is that that portion of the claim based upon this five million dollars should be and is held as **secondary to the rights of the bona fide creditors** of C. T. B."

It is apparent that at least to the extent of the $5,000,000, plus accrued interest of approximately another million dollars, *that creditor stands in a different position.* The fact that a claim was allowed in the 77B proceedings *insofar as it relates to the assets of the Debtor,* does not make that creditor, who participated in the fraud and *who knew of the sale,* and who itself made the sale, *a participant in a cause of action by defrauded creditors.* The fact that the "parent" was allowed a claim in the 77B proceeding against its Subsidiary does not adjudicate the right of the parent which was a party to the fraudulent sale to participate in a cause of action *against third persons* by bona fide creditors who were defrauded.* Both the Debtor and Subsidiary Debtor were mere instrumentalities of the Van Sweringens, and they do not stand in the position of the bona fide creditors who were defrauded. At any rate, *such were the allegations of the complaint which they admitted to be true,* and they cannot seek to sustain their motion by denials.

---

* This alone is sufficient to demonstrate the absurdity of the contention that the right of action belongs to the Debtor. Under this theory the result will be that creditors who participated in committing the fraud, would participate with the defrauded creditors in the proceeds realized out of the cause of action, which under no theory of law was available to the creditor who committed the fraud or who was a party to it.

III.

The District Court in the 77B proceeding was without jurisdiction of this cause of action, and the action was not an interference with the orderly and proper administration of the Debtor's estate.

This subject matter was fully discussed in our Brief (pp. 29-32). The discussion in respondents' brief of this point under Point III is not responsive and none of the cases cited by them are in point. The *Greyling* case (p. 18) was shown above to have no bearing on the question involved. The quotation from the *Los Angeles Lumber Products Co.* (p. 19) is repeated from the first part of the quotation appearing on page 15 of their Brief, and we have already shown that that paragraph confines the jurisdiction to the *res*. The decision in *Re 7000 South Shore Drive Building Corporation* (86 F. (2) 499), stands for the doctrine that "exclusive and paramount jurisdiction over the *res* of the estate passed to the court of bankruptcy," which is not at all in dispute.

On page 20 counsel say:

> "The chaotic condition of the administration of the bankruptcy estate cannot be over-estimated if creditors such as plaintiffs here are permitted to maintain actions after a debtor corporation has taken steps under Section 77B to reorganize."

A chaotic condition in the administration of justice would indeed follow if the respondents will prevail. Here was a cause of action which if true, as contended by the defendants, was available to the Debtor a year prior to its filing of its voluntary petition for corporate reorganization. No such action was commenced. *Five years (less twelve days) elapsed,* and no action was commenced by the Debtor. If plaintiffs did not commence the action it would have been outlawed by the Statute of Limitations. When the action was commenced the Debtor

refused to join because it considered the action *worthless.* It later applied to the Court for instructions to commence the action at an expense of $25,000.00. The Court instructed the Debtor not to commence the action and *dismissed its application,* and no action was ever commenced. The subject matter of this suit has never been, nor is it now, under the administration of the District Court in the 77B proceeding, yet it is urged here that the allowance of the prosecution of this suit by the creditors who were defrauded at their own expense would create a chaotic condition! They claim that a chaotic condition would result from the fact that the plaintiffs asked for the appointment of a receiver during the pendency of the cause to take charge of all the property belonging to the trust estate. *The Receiver was not sought to take possession of any of the property of which the Bankruptcy Court is possessed.* The receivership was sought (R. 18) of the property which the defendants, *third persons,* are possessed of and *which is not in the possession of the bankrupt nor in the possession of the Bankruptcy Court.* In any event, the prayer for relief to which one may not be entitled is no obstacle to the relief to which a creditor is entitled. If the Court will decide that no receiver should be appointed it will deny the relief, but this is no obstacle to the right of action.

In answer to the point made in our Brief (pp. 20-21) that the Debtor, having refused to prosecute the cause of action, the right accrued to the plaintiffs as creditors, and even if the cause of action belonged to the Debtor, the jurisdiction was relinquished counsel say (p. 20):

> "No question is presented here respecting the abandonment by the Trustee of any cause of action against these defendants which it might have."

The question is presented by the record. *It is they who presented the question.* They brought in by their motion

to dismiss the records consisting of the complaint filed at Cleveland, the report of the Master and the Exhibits attached thereto (R. 14-34). We did not want to resort to technicalities on the point that they had no right to bring in these documents under their motion to dismiss and therefore stipulated (R. 35) that these records may be considered. *Having brought in these records which disclose the abandonment by the Debtor of the cause of action as it appears from its record* (R. 27, 28), *they cannot now about-face and claim that no such question is presented.*

The decision in the *Moyer* case (p. 21) on the point that the refusal or failure of a Trustee to sue does not transfer the cause of action to the creditor has no bearing here as there was no discharge in bankruptcy. It has no bearing to a proceeding under 77B *where a Court may relinquish its jurisdiction to certain phases* in favor of another Court, as shown in our brief (pp. 26, 27). We find no answer to the argument nor are the authorities disputed.

IV.

The decisions are conflicting and irreconcilable.

The attempt to reconcile the conflicting decisions (pp. 22-24) is in vain. A reading of the cases will dispose of the unsuccessful attempt.

The recent decision of the Sixth Circuit in the Gochenour appeal and which was mentioned in the petition (p. 9) is quoted at length by respondents. The opinion is not yet officially reported but appears in C. C. H. Bankruptcy Service at paragraph 53.052. We stated in the petition (p. 9) that this opinion squarely holds against our contention, but we intend to apply for a review of that decision. This does not detract from the fact that

there is a conflict between the various Circuits on the main question whether or not the right of action belongs to the petitioners as creditors or to the debtor. The opinion contains also, among other things, the following:

> "On September 30, 1935, the Midamerica Corporation purchased at private sale from Morgan & Company, for $318,000.00, the collateral on the subsidiary-debtor's note. Subsequently, Midamerica sold these securities for $6,805,800.00, and went into liquidation, distributing the proceeds of the sale to its stockholders. The subsidiary-debtor was insolvent at the time these transactions occurred."

In commenting on the failure of the debtor to take action and on the fact that the Court did not bring this asset under its administration, the opinion says:

> "However, it is not the purpose of the Act to furnish immunity to wrong-doing by corporate officers. On the contrary, it is the plain duty of the court to direct the investigation of all substantial allegations of mismanagement or fraud. Under the Act, if a corporate debtor is continued in possession of its assets the judge may at any time, appoint a disinterested person as an examiner to perform the duties imposed upon a trustee. (Ch. 541, Sec. 168, as added June 22, 1938, ch. 575, Sec. 1, 52 Stat. 890, Title 11 U. S. C. A., Sec. 568.)
>
> In the present case the court below, as its orders clearly indicate, has not considered the practicability of the appointment of an examiner. On the face of the information in the record there are reasonable grounds to believe that the officers of the subsidiary-debtor through their control have improperly acquired its assets and by reason thereof, have become indebted to the corporation to the extent of the profit they have realized by reason of their misconduct."

It afforded the following remedy:

> "While the petitions filed by appellants were not filed on behalf of the subsidiary-debtor, neverthe-

> less, they will be treated as presenting sufficient facts to require the court to appoint an examiner and if facts are produced upon a hearing which convince the court that suit should be prosecuted for the benefit of the subsidiary-debtor against the officers, stockholders and directors of the Midamerica Corporation, an order will be entered authorizing the subsidiary-debtor to prosecute the suit or if the court deems proper, it may give appellants, as creditors of the subsidiary-debtor, the right to institute suit in its name after indemnifying it against cost. Cause remanded for proceedings consistent with this opinion."

This "cure" if administered, may not save the "patient," as the Statute of Limitations has now elapsed (see Petition, p. 31) and no matter what an examiner may discover, it may not bring relief to the creditors or to the bankruptcy estate.*

For the foregoing reasons, we urge the allowance of the Writ.

Respectfully submitted,

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* After a lapse of about six years, the Bankruptcy Court is to appoint an examiner, who is to hear evidence and submit a report to the Court, which will then determine what further steps are to be taken. During the six-year interval, Midamerica, a resident within the Federal District where the bankruptcy proceeding was pending, succeeded in disbursing the funds to the respondents, Indiana residents. What further steps will be taken by the respondents between the time that will elapse for such examination and determination by the Court can, of course, not be foretold at this time. While the appointment of an examiner would be a great aid if the cause of action would remain pending, it may be of no use for the reason that the officers and directors will be able to interpose the defense of the Statute of Limitations.